THE WILLIAM J. COOPER FOUNDATION

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SWARTHMORE COLLEGE

WORLD TRADE

And Its Future

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WILLIAM J. COOPER FOUNDATION

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WORLD TRADE

And Its Future

By

Sir Arthur Salter

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PREFATORY NOTE

The following five lectures were delivered at Swarthmore College, in the spring of 1936, upon the William J Cooper Foundation They are published in the form in which they were prepared for that purpose and without modification except in small points of detail

The audience for which they were designed consisted mainly of persons interested in public affairs and occupied in various pursuits or branches of study, with a certain number, but not a large proportion, of professional economists

The lectures aimed therefore first at describing in broad outline, and without technical detail, the course of the development of international trade in modern times, and the principal factors which have determined its volume, its character, and its organization, and then at suggesting a certain course of policy adapted to the conditions of the present, and the probable conditions of the near future

In this latter part I include certain suggestions which may I hope be of some interest to economists, and to those engaged as officials in forming commercial policy But the form in which these suggestions are made is determined by the general purpose of the lectures They are only presented in bare outline, on a scale appropriate to my general treatment of a large subject within a small compass I must advocate them elsewhere with further elaboration and more technical detail, and indeed have in some cases already done so My present purpose has been rather to suggest a certain general orientation of policy than to present an actual program

ARTHUR SALTER

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I

WORLD TRADE BEFORE THE WAR

I PROPOSE in these five lectures to discuss the future form and pattern of International Trade My subject is not the amount, or the value, or the character of the goods and services that will probably, in the period ahead of us, be exchanged between people in different countries It is the system under which this exchange will take place, the methods by which the producer will find the consumer, the organization, whether governmental or unofficial, which will influence or determine the main channels of trade, and the policy which, among the practicable alternatives it is wisest to pursue

I have chosen this subject for several reasons I think an enlargement of external trade beyond its present dimensions will have a considerable influence upon the standards of living which the people of each country will be able to attain within their respective national frontiers I believe secondly that the methods adopted by individuals and by governments to extend their foreign trade will be of great importance to the peace as well as the prosperity of the world And finally, I think that since the general structure of the world s modern economic life, and consequently the system appropriate to the development of external trade, will be substantially different from those of the past, the methods by which we have in the last two decades sought to reopen foreign markets will need also to be changed

To introduce the tentative prophecies and proposals which I shall attempt later, I must first consider the environment within which world trade has developed, and

the new environment to which in my view it will now require to be adjusted.

The present structure of our economic system has grown bit by bit out of the past, and the future will grow out of the present. I can, therefore, only construct my picture of what I believe will be the future form and pattern of world trade by tracing its development and analyzing its present character. I shall have to follow a single thread through recent events, and to show how it intertwines with the other threads that make up the complex pattern of economic history, before I can suggest the new pattern of the future. My earlier lectures will therefore be devoted to sketching in outline the course of modern economic development, from a particular point of view and with special emphasis on those events and elements in it which seem to indicate what will be the character and course of world trade in the decades ahead of us. Little by little during these earlier lectures I shall be trying to gather the bricks which I shall use to build the new structure which I shall present to you towards the close. I shall thus in turn deal with changes in international trade, and especially in the environment of law, official action and economic organization which determines its character, first before the war, then during the war period and the following decade, next during the world depression and crisis. With this introduction I shall try to analyze the present situation, distinguishing what is temporary from what is of enduring or permanent importance. I shall thus hope to be better able to guess the future and to suggest the methods by which we can best enlarge trade without encountering obstacles which will make our future efforts as futile as those of the last twenty years have been.

What is international trade? The very phrase has been

the parent of many fallacies For normally it is not nations but individuals that trade with each other All economic progress is based on specialization of function and exchange of goods and services This process extends its range and increases its benefits as men trade with each other first in small local communities then with those of more distant parts of the same country, then with those of other countries But what is the essential difference when this last extension of range is reached? Why do we speak more of international trade than of inter urban, or inter provincial or inter state trade? The answer is clear Men buy and sell, and compete, either as individuals or specialized groups, wherever they live It is only so far as these reciprocal activities are subject to some form of collective regulation or intervention by an authority operating within a defined geographical area and affecting the conditions under which the competing units carry on their work, that any particular geographical unit of classification becomes more important than any other And it is because such collective action is usually governmental, and the principal units of government in the world are national, that international trade" becomes a significant distinction as compared with all the transactions which take place within a smaller range than is comprised within national frontiers If a national government establishes, as the medium of exchange for domestic transactions, a national currency which has a varying value in relation to other national currencies, if the taxation it imposes, or the regulations it enforces as to hours and conditions of work or wages change the conditions under which its nationals compete with those of other countries, above all if it uses the powers of the State to assist particular branches of enterprise by means of protective tariffs or subsidies, or participates in,

or even transfers to government ownership and control, an enterprise which buys and sells abroad—international trade acquires a real and important significance. The exchanges between the goods and services of different countries become different in vital respects from those which proceed within the same country. The importance of international trade as a classification within the total of all exchanges of goods is exactly proportionate to the extent of governmental action at any period. From which one conclusion follows, that the importance of international trade as a classification may be greatest exactly when its content is least. Under certain conditions, such as those which obtained for the most part during the last century, international trade may be enormous in value and volume; and at the same time the distinction between that trade and all other forms of exchange may be so little as to make the very name an irritation to economists and a fruitful source of fallacies and misunderstandings for the public. The situation is, as we shall see, now very different indeed. International trade as a distinction in classification (as contrasted with what might be called intra-national trade) has become more significant; as a proportion of total trade it has been considerably reduced.

With this preface I must now attempt to sketch in bare outline the conditions under which international trade was carried on before the war. I shall not delve deeply into past history. I need scarcely go farther back than the last century. For before the industrial and mechanical revolutions international trade was really a very small factor indeed in the general life of the world. How small it was we are apt to forget because of the way in which we study history. It is of course true that foreign commerce was the foundation of such a rich and powerful State as the Venice

of the Doges, that it gave medieval Spain its greatness, that it was a great factor in the political power of England and France and Holland long before the nineteenth century, that it created wealthy classes in these and other countries which provided the soil for a rich flowering of civilization All this is true, and foreign commerce is therefore important in political history and the growth of civilizations But it must not make us forget that for the great bulk of the millions of mankind it was the merest fringe upon the fabric of their economic activities Till the railway era the basic fact in man s economic life was that, with negligible exceptions, he could neither travel nor send his messages faster than a horse could run It took Napoleon as long to go from Paris to Rome as it had taken Julius Caesar nearly a millennium before Till the era of mechanical inventions the advantages of such a degree of specialization and large scale production as was dependent upon distant markets were very limited and at the same time the difficulty of transport made such markets impracticable There was foreign commerce in treasure and spices in return for wool and textiles and so on But it was a supplement and not a part of the main substance of the economic life of almost all men in almost all countries The vast bulk of mankind lived, even in countries like ours, in little and poor communities of village and market town, with a few capitals to which those not resident in them traveled slowly and rarely The craftsman would find his raw material of wool from the sheep around him, his power from the coal or water at his doors, and his customers in his neighbors Not only each country, but each district, lived mainly to itself It served its own wants, it depended for its fortunes mainly on its own efforts or the accidents of local events Apart from war and the consequent increase in taxation, it

was little affected by what happened a hundred miles away.

And so in a myriad economic units man lived a small-community life. It was a life poor in material comforts, for it was limited to what could be provided by the skill and industry of a few people, aided by primitive tools and apparatus and utilizing resources available within a small area. Wealth and the standard of living were on a much lower level. But they were in some respects much less precarious than they have since become. Local disasters remained local in their effects. There was, and could be, nothing comparable to the present situation in which the fortunes of the remotest factory or home are involved with far-off events and actions beyond control or knowledge; by a shortage or misuse of gold; by excessive Government debts or ill-judged commercial policies; by the alternation of extravagant optimism and pessimism of distant speculators; by harvests and droughts or wars in another hemisphere, and so on.

Then suddenly, in a few years, after the economic stagnation or slow progress of many millennia, came the torrent of new inventions which transformed the conditions of human life. I will not attempt to repeat the tale of the miraculous period in man's history that followed. What matters for my present purpose is that the new inventions offered the greatest rewards to extreme specialization, to large-scale production, to the development of markets adequate to absorb the products, and that improved communications gave the physical possibility of reaching these markets.

Now the reward of specialization is increased production. Its price is that, since it magnifies the range over which goods must be exchanged and multiplies the interdependent units of human effort, each one of which must

be kept in balance with the rest before any given economic activity reaches its fruition, it requires a system under which all the necessary adjustments will be continuously made The system must be as wide in range as the area over which exchanges take place flexible and strong enough to permit and compel adjustment throughout the whole net work of multitudinous and infinitely complex interacting processes Change anywhere means damage everywhere, unless and until a corrective adjustment is made to its consequences Failure to adjust means waste The difference between our comparative impoverishment and the potential plenty which the full use and development of our productive skill and resources might permit is due and due entirely, to the defects of the system of adjustment as it now works Unemployment is a precise measure of the cumulative effect of all forms of uncorrected maladjustments

We shall fail to understand any of the principal economic or political questions of our time unless we realize the extreme complexity and intrinsic difficulty of the process—of any process—by which the infinite multiplicity of separate units of work are and must be linked and adjusted to each other It is only too easy to take this process for granted when it works and to regard any defect in its working as a proof of inexcusable human folly It is only too easy to be fatally misled by the oversimplified forms and phrases in which the issue is so often presented to it We speak, for example, of plenty and of impoverishment of supply and demand, of production and consumption, as if we had two more or less homogeneous masses of human effort and human need that only require to be related to each other After which the simple remedies of charlatanry suggest themselves naturally and plausibly If pro

duction exceeds consumption, and could be increased sti further if consumption increased; if human needs excee human satisfactions and almost everyone would buy mo: if he had more money—surely the remedy is clear. Mal more money and distribute it, and all will be well. Tec nocrats and Townsendites and Douglasites *et hoc gen omne* press their simple specifics upon us. They all sta with the indisputable truth that our productive capaci and resources are enough to increase greatly the standa of living; and the further truth that if people had mo money they would spend more, and more spending wou stimulate more production, and so on. And here and the one of their specific proposals, on certain conditions ar in relation to a sound general policy, might really contri ute to increase our prosperity. But in truth there is r simple remedy for maladjustments of many kinds, pr ceeding from many causes. There is no simple system f an intrinsically intricate and complex task of adjusting multitudinous variety of human activities and huma needs. "Production," yes, but men don't just "produce they produce an immense variety of quite different thin by an infinity of different interacting efforts. "Consum tion," yes, but men don't just consume, they consume a infinite variety of different things, for which their dema is constantly changing with taste, caprice, the opport nities for new satisfactions, and the relative value attach to alternative objects of expenditure within the limits s by total income, and so on. We must think, not of equati consumption to potential production, or demand to p tential supply, but of adjusting an infinity of changi processes to an infinity of changing human desires. So d ficult is it to escape the fallacies of over-simplification, a at the same time so essential if we are to understand t

real problems of our system as a whole or of any particular part of it such as the one I am discussing in this lecture, that I suggest that we should all start by making a deliberate effort to conjure up before our minds a picture of the real complexity of the economic life of the world Take, for example, any simple object, a chair or a pair of shoes or an automobile, and deliberately reconstruct the long chain of linked processes which has preceded the utilization of the finished article by the individual consumer The raw materials drawn from many lands, the systems of organized production, industrial relations, and monetary transactions involved before these raw materials are available, the shipping and transport organizations required to move them, the financial and monetary system required to install the machinery required both in the original country of production and in the place of manufacture, the merchanting organizations from beginning to end, including the final advertisements and methods of salesmanship the mining of gold which is related in different ways to all the currencies and contracts involved down to the last payment by the purchaser in treasury notes and metallic token coins the way in which any change in any one of these many links necessitates a corrective change through the whole And then think of all the other similar chains of linked processes each interacting with the first and with each other, each ending with a commodity which competes for a share of the limited total expenditure of the individual consumers at the end of the chain In this way we may begin to get something of a true picture of the real complexity of the economic life of the world and of the intrinsic difficulty of constructing a system under which it can develop without intolerable waste But we shall make a fatal mistake if we conclude with confusion and despair

The problem is difficult, but it is not insoluble. The conclusion must not be inaction, or surprise that in such complex conditions things get adjusted even as well as they do, or a mystic attitude of veneration towards our economic system like that of Burke towards the wonderful intricacies of the British constitution, which had, he thought, so many merits dependent on causes he could not fully understand that he was afraid to attempt to remedy its obvious defects. Our conclusion must be that we need not some single and simple specific, or reform in some single spasm of energy—but a long, deliberate effort of the constructive intelligence.

We may draw encouragement from the fact that for so long the world seemed to have found a solution, did indeed so nearly find a solution, for the conditions of a great period of human history.

This temporary solution, which seemed so long to be worthy of permanence, is the system under which the harvest of the new treasures of invention was reaped and extended far over the world—the system under which all the intricate processes of specialized human effort were adjusted through competition and changing prices, private enterprise and profit, within governmental policies of laissez faire.

We must understand what this system was and did before we can justly judge where and how it has broken down, and how we can best replace, or modify or supplement it, whether in relation to internal or to our own special subject of international trade.

What was this system in principle and in practice?

The underlying principle is quite simple. Let the government of each country establish a bare framework of law and order; defend against external aggression, sup-

press civil violence, enforce the observance of contracts, institute a stable currency as a medium of exchange—which could become a world currency by being linked to a gold standard—and then *laissez faire, laissez aller*—stand out of the way and let the individual get on with his job without interference Within this simple frame work every individual, unable to produce all he wants for himself, will make more than he wants of what he can produce best and exchange the rest for the different prod ucts of others similarly specialized and acting under a sim ilar stimulus Since no one can sell except to a willing purchaser, since no one need buy except what he wants at a price he thinks worth while, every exchange will in volve a benefit to both parties No one under these condi tions can secure private profit to himself except by bringing a benefit to others He cannot secure wealth for himself except by producing more total wealth than he is enabled to consume Private profit must therefore increase the public good Since the individual must be the best judge of what he wants and since the specialized producer will, under the stimulus of personal advantage, seek out more eagerly what others want than any external and less interested general authority could do, such a system must clearly secure a greater total of human satisfactions than any other could possibly do Competition must always com pel an individual producer to keep his prices near the cost at which he, or those competing in the same business, can produce And, with competition, every time any particular class of goods or services exceeds the demand of the public for them at the current price, the price must obviously fall, demand will rise, production will be discouraged, and the process will continue till supply and demand are again in equilibrium The converse corrective process will operate

just as successfully when any class of goods or services is for the time in deficiency. Since this simple and automatic force operates upon every unit of the economic process, not only as regards the actual production of commodities but every form of service, upon the provision and allocation of capital through a varying interest rate, upon the relative attractions of occupation in personal service or industry or agriculture, there is a corrective force always at work in the economic system, adjusting and readjusting every unit in it to the others without any general authority requiring to control or direct, or even to know what is happening. Thus the strongest of all motives common to mankind, the desire for personal advancement, is harnessed to the public good, and the same force is utilized to keep the whole of the economic process in balance and equilibrium.

This was the principle. Granting its basic assumptions, its conclusion that private gain and the public interest must coincide seemed to follow with all the certainty of a proposition of Euclid. These assumptions were roughly that there would be free competition between many separate units in each sphere of activity, that there would be a margin of free resources of all kinds sufficient to prevent competition being ousted by monopoly, that the competing individuals and groups would really be in a position to judge of their own interest better than any external authority and would not be prevented from doing so by excessive inequality of bargaining status or the pressure of immediate need, and lastly that government would establish its effective framework of defense, law, and order, compel the enforcement of contracts, and maintain a satisfactorily stable currency as a medium of exchange—and would refrain from doing more. Upon these assumptions,

and with a system thus established, everything, whether a commodity or a service, which was at any time in excess in relation to others would be reduced by falling prices and whenever anything was in deficiency rising prices would increase it Everything depended upon the system being such as to compel this response to this motive force—and it was difficult to see why on the assumptions stated it would not always do so, or how the system in that case could fail to be the best of all possible ones

Well, the mere recital of these assumptions is enough to suggest t e flaws in the theory and the reasons why great imperfections gradually de ped in practice These assumptions were never perfectly realized and, to the extent to which they were not, the practical consequences failed to correspond with the logically deduced result But for a long period the assumptions were near enough to realization for the exceptions in practice to be of comparatively little importance—and for the imperfections of the system to be overwhelmingly outweighed by its merits

It is important to realize how universal in its range of operation was the simple principle which I have stated It underlay not only the adjustment of the supply of goods and personal services but the whole financial and credit system Currencies for example were based on gold and silver The purchasing power of currency was in the last resort determined by the individual calculations of metal producers as to whether it was worth their while to work mines on the margin of profitability When prices fell generally a given amount of currency, and therefore of gold would buy more goods than before and it became profitable to work the less as well as the more productive mines so that the supply of gold would increase and prices would therefore tend to rise again When prices rose the

opposite regulative force would come into operation. The supply and flow of capital were determined in just the same way, changing rates of interest serving the same purpose as changing prices did for commodities. If people were saving too little to provide the capital plant required for expanding enterprise, interest rates would rise and they would have a stronger inducement to save more. And when adventurous enterprise in distant and undeveloped lands offered more profit with more risk, the necessary capital would be attracted by the automatic increase in the rate of interest or dividend forthcoming as compared with the safer forms of investment available at home. The individual investor, guided by the expert advice of issuing houses which his eagerness to increase his fortunes brought into existence, was able to judge as between the advantages of home and foreign investment and the respective merits of different enterprises competing for his savings. By a process almost as automatic the balance of trade was adjusted between different parts of the world through the working of the monetary system. For national currencies were linked at fixed parities to gold, and therefore maintained, within narrow limits, a stable relation to each other. If at any time the nationals of one country were buying more than their exports enabled them to pay for, the gold reserves of the country—the reserves necessary to enable currency to be exchanged at any moment as they could be under the gold standard system—would flow out of the country in settlement of the balance. The Central Bank of the country, whose duty it was to keep itself always in a position to give gold in return for currency on demand and therefore to maintain its gold reserves, would tempt gold back by putting up the Bank rate and therefore making it more profitable for foreigners to send money in to

enjoy the higher rates of interest The increase of the rate of interest would in turn reduce production and therefore prices, and this in turn would increase exports and reduce imports This simple method, which has, as we shall see, since had a sinister history as involving 'deflation,' worked with some but not intolerable hardships in the last century, and in time it was bound to bring back a due balance of trade A Central Bank did not need, no one needed, to *estimate the trade of the country as a whole All it had to* do was to watch its gold reserves and replenish them when necessary by the simple device of Bank rate And so throughout the whole of the vast and intricate system Its distinctive feature was that it enabled all the innumerable adjustments of the economic process to be self regulating *and automatic Over the whole range of human activity,* need and effort, demand and supply were adjusted to each other without anyone estimating the one or planning and controlling the other The individual entrepreneur would feel his way to a new or expanding market, with the movement of prices as his guide

This infinitely complex and intricate system, self regulating and automatic, is perhaps the most marvelous of all the collective creations of man It has an intellectual fascination scarcely to be equaled in any other sphere, for all who have studied it It was built by the separate efforts of innumerable men, no one of whom understood the *working of all its parts To those who have studied it* it is more like a living creature, working by instinct, with an infinitely intricate and delicate adjustment of organs to function, than any of the deliberately planned and con*structed works of man And while the environment* in which it had evolved remained, it served *its purpose* with subtlety, precision, and exactness—and with astonishing

success. A new environment of industrial technique and governmental action, as we shall see, now necessitates a system in which, as regards both internal and external trade, deliberate reason must in part replace instinct. The success of the self-regulating process was dependent upon a fortuitous combination of temporary and precarious conditions. But while those conditions remained it served the world well.

It gave full scope for the utilization of new inventions which multiplied nature's gifts beyond imagination. It enabled the structure of a mechanized civilization to grow and expand till it sheltered hundreds of millions in comfort far beyond the primitive standard of the solitary peasant, which has been the normal fate of all but a few minorities throughout the ages. It enriched the life of typist and artisan with the treasures of every clime and continent. And no other practicable system could have done so much. No collective and controlling authority, whether of the State or of institutions external to it, could under the political and economic conditions of the great century of expansion have conceivably served mankind so well.

Now let us consider this system in special relation to international trade. The simple framework of State control which it required made it easy to secure the conditions under which trade could expand indefinitely under the stimulus and guidance of private profits. A metallic standard, gold for most countries, silver for the rest, gave a sufficiently stable medium of exchange. The range of variation between "gold points"—the prices at which it became worth while to export and import gold, was moderate and limited—not enough to offer a serious obstacle to normal transactions, just enough to maintain the balance of

trade in equilibrium The enforcement of law and order and the observance of contracts by national governments was in general sufficient Where necessary it was supplemented by localized special regimes as in Shanghai occasionally by the menace of naval demonstrations as against Venezuela or even by occupation and control as in Egypt But in general the observance of contracts by the nationals of less advanced countries was secured by the conditional prospect of further benefits to come The financial resources and potential favors of the richer countries backed by the usually only latent power of their armed forces secured a framework within which the private adventurer could pursue his profit to the advantage both of himself his compatriots and on the whole though not without serious exceptions of those with whom he traded in all lands The legal systems of the more advanced countries were sufficiently similar for their separate action to constitute in effect a single system of law within which their nationals could deal with each other Their conflict with each other was in general competition only of the same kind as with their own compatriots such quarrels as arose were the quarrels of individuals only usually capable of settlement by an available tribunal and in any case not sufficiently general to endanger international relations Occasional commercial conventions were necessary to coordinate and supplement the operation of the commercial policy and legal systems of the different States but these could be arranged by the ordinary procedure of diplomatic negotiation

Under such conditions international trade expanded enormously and spread the benefits of the new inventions throughout the world Countries comprising the vast majority of the human race which had hitherto been restricted

beyond bare sustenance, to products of craftsmanship aided only by the simplest of mechanical apparatus, found a very different future opening before them. Railways imported from the western world enabled them to sell their produce of food and raw materials in return for all the products of mechanized manufacture; many of their inhabitants attained riches, and most a substantially higher standard of material comfort. Capital flowed in a fertilizing stream from the industrialized countries, which in turn found a productive outlet for their savings, and, as a closely related counterpart, an expanding, and apparently illimitable, market for their goods, and consequently also an economic basis for their increasing populations. Great Britain was the leader and, during the period of greatest expansion, far more important as an exporter than any other country. The United States, while increasing its population and wealth even more rapidly, found its field of expansion in the vast area comprised within—or brought within—its own sovereignty. Its external trade was comparatively small, and throughout the last century it was importing, not exporting, capital and buying more from outside its own frontiers than it was selling.

In spite of local and occasional difficulties and interruptions, and the faint foreshadowing of troubles destined in the next century to be serious, the system worked with a marvelous success. Decade after decade, the populations of the United States, of Great Britain, and of Europe increased, were absorbed into productive employment, and attained constantly higher standards of living. Both international and domestic trade, the need of adjustment to each other of all the infinity of separate human units of effort and skill both within and without national frontiers, seemed to have

found a system which provided all that was necessary in a system of private competition, changing prices, and laissez faire within a bare framework of law With such astonishing success to its credit, it is not surprising that the defects latent in the nineteenth century were not then visible, and the extent to which its efficacy depended upon conditions which could not be permanent was not realized In the retrospect of later disaster we can see what these conditions were, and can realize that some of them, which were then taken for granted as apparently a part of the order of nature, were fortuitous and temporary It is worth while to consider the more important of these conditions so far as they are directly related to international trade

In the first place, while there was intense competition between individuals within each main type of country, trade as between those of different countries was far more complementary than competitive The raw material and food producing countries of the world sold their produce to the industrial countries the whole of the world economy found its equilibrium in this fundamental relation The one type of country had no industrial development which seriously restricted the need for imported goods or created any motive for imposing obstacles to their admission And even the competition between the industrial countries themselves was of limited dimensions Great Britain had a long lead over European countries, she could extend her markets as fast as she could increase her production, when others entered the field there was for a time room for all The second of these factors had changed substantially before the end of the nineteenth century, and the first was beginning to, we shall consider later in what way and with what consequences But throughout the greater part of the nine

teenth century the whole system of trade was greatly assisted by the extent to which it was, internationally, complementary rather than competitive.

In the next place the fact that Great Britain had a position of such overwhelming priority in all that related to international trade made possible a unity of policy and direction as regards the main institutions on which it depended without necessitating anything like real international government, or anything more than the simplest forms of international agreement. Her immensely greater capital resources available for foreign investment (those of the United States being absorbed by internal development); her much greater external trade; her first arrival on the scene as the agent of development in most of the new countries; and behind all the invisible but potent influence of her naval invincibility—all contributed to make London the financial center of the world, and enabled the simple but necessary framework for the operation of both the general financial system and the gold standard to be established and maintained.

I may perhaps be allowed to claim that the slowly evolving policy and traditions of Great Britain made her singularly suitable for this rôle. She developed institutions through which her capital was wisely directed, and applied with some exceptions to productive use which created much more real and regularly increasing wealth than the lenders exacted for their services, the balance remaining as a net benefit to the borrowers. Moreover, investing habits and the policy of the issuing houses resulted in the continued outflow of new capital approximately equal to the return from capital previously invested; so that the world's exchanges were not burdened, or the maintenance of the gold standard rendered difficult, by large net transfers of money. The

general policy of Free Trade, adopted as in the best interests of an exporting and lending country, constituted an environment peculiarly suitable for a world financial center, and greatly helped to give flexibility and elasticity to the whole system The strength of the navy was used with restraint It policed the seas to the benefit of all countries And if it enabled English traders to carry on their business in foreign countries with weak governments, and maintained a large empire under the British flag its strength was rarely abused In particular it was never used to secure a monopoly of the resources or the markets of the Colonies, which were open to the goods and enterprise of all comers upon equal terms

Under these conditions the whole system, financial and monetary, upon which the adjustments and equilibrium of international trade depended, worked without friction and almost automatically, with a certain nucleus of central direction whose existence and whose value were not even realized till, under the new conditions of the post war period, they were lost

The international trade which so developed was for several reasons of inestimable value, beyond any measurement of it in statistics, to countries whose industrial productive capacity was rapidly increasing

In the first place the large scale of the markets thus opened permitted and encouraged larger scale production than would have been possible with a purely domestic demand, and in this way extended and multiplied the economics of specialized production which is the basis of all economic progress

A second advantage was of even greater importance The opportunity of external expansion in markets where the general standard of living was lower, and a demand was

therefore constantly becoming effective for just those classes of articles which were in danger of reaching saturation point at home, was of inestimable assistance to the whole capitalist system at its point of great weakness.

So completely was this weakness thus remedied that its very existence was not realized. A whole school of classical economics developed, and with its support a general conception of the economic system, which assumed as normal and inevitable the precise characteristic whose absence is at the core of our principal post-war troubles. As Mr. Maynard Keynes has been demonstrating in his recent book, it assumed that—apart from certain transitional or "frictional" unemployment of limited and specific kinds—there would always be full employment; that employable labor itself would create, or find available already existing, opportunities for new enterprise and investment sufficient to absorb it; and that with this expansion at the frontiers of the economic system all the multitudinous adjustments of every human unit of effort to every other would be secured by the automatic operation of competition, changing prices, and changing wage rates.

These adjustments were in fact secured, without any excessive waste and dislocation, because of the life and vitality which were given to the whole system by the extension of demand to new classes of purchasers. The extended demand came partly from the inhabitants of less advanced countries reached by international trade, and partly from the constant and rapid increase of the population at home. This double extension limited the consequences of any errors of calculation tending to excessive production in any sphere of economic activity. Supposing, for example, that over-optimistic calculations on the part of makers of boots or chairs as to the extent of demand at a given moment (or

the total effect of the optimism of individual manufacturers as to the share they could capture of a total market correctly estimated) led to an excessive production of those commodities Prices would fall output be reduced and soon—without any scrapping of plant or long unemployment of the workers concerned—new purchasers abroad or the natural increase of population at home would correct the position The factories would be fully at work again and could keep in equilibrium merely by retarding their subsequent rate of expansion for a time What has thrown such a strain upon the capacity of the economic system to effect its adjustments is the rapid and simultaneous disappearance of both these outlets International trade has declined instead of increasing while the home populations of the advanced industrial countries have lost their former rate of increase have become almost stationary and will shortly decline

Now it is theoretically possible for full employment to be maintained for full industrial capacity to be utilized even within a closed system with a stationary population But the adjustments required are infinitely more difficult All sorts of traditional habits—as to the relations between spending and saving between profits and wages and so on require to be changed and much more transfer from one form of specialized occupation to another is necessary It is intrinsically a very different thing to adjust production to a temporarily inadequate demand till demand has again overtaken supply and to adjust productive capacity to a permanently reduced demand The new environment resulting from the cessation of increase in purchasers is one of the principal underlying causes of the many maladjustments between different parts of the economic process whose total visible measure is given by idle industrial plants and the numbers of the un

employed. In time perhaps new habits as to saving and spending, new customary rules of policy, new arrangements for maintenance and training and transfer, might restore the necessary vitality and capacity of adjustment to the economic system, working under the old impetus and guiding forces. But in the meantime the whole system, deprived of its previous outlets, is clogged. The case for at least the partial use of collective planning and direction, whether by the State or not, is greatly strengthened. And, in any case, whether rightly or wrongly, the State under public pressure and the visible distress caused by the failure of the unassisted economic system to absorb and adjust in the old way, is forced into various forms of action. Each of these while giving local relief causes interferences with the automatic operation of the economic system in other spheres, which in turn compels further State action.

In a word, the characteristic disease of the capitalist competitive system after its first stage of development is a kind of middle-aged constipation. Increasing population at home and external trade were the most effective of aperients. They are no longer available. As soon as the industrialized America had passed the frontier age; as soon as Great Britain could no longer find increasing foreign markets for her increasing industrial capacity; as soon as countries with rapidly increasing populations, and inadequate domestic resources, like Italy and Central Europe, could no longer find an outlet in emigration to America—a new and more difficult era was inevitable, in which each country would be thrown in upon itself and would need to find means of expanding its internal markets, with all the consequent changes in organization and policy involved. In this era, whose difficulties were further increased by all the dislocations of the war, the old economic system proved incapable

of making the new adjustments—or of making them quickly enough for an impatient public This is one of the principal origins of the extension of State action The other is the growth of large economic organizations—whether of industrial combines or trade unions—within the economic system which have further restricted the free competition and operation of the changing price method of adjustment

The great value of international trade—or of such an opening up of new territory within its own frontiers as there was in the nineteenth century in the U S A which served the same purpose—was thus that it prevented the clogging up of the economic system and the consequent impairment of its ability to secure adjustments of economic processes by changing prices And this is why the establishment of political conditions which would permit the development of such a country as China with its immense population on a low standard of living would now give as nothing else could give a new lease of life to the old system

We can see in retrospect the latent defects of that system and the fortunate combination of circumstances which made them of little practical importance at the time much better with the experience of our own century

But already in the last century there were ominous hints of troubles to come Pressure upon reluctant creditors by the demonstration of naval force occasional occupation as in Egypt upon default the insistence backed by naval or military strength on special régimes as at Shanghai or on an open door as in China as a whole were successful for the moment But they were exceptions to the ideal laissez faire system in so far as they involved State action outside the sphere of enforcing law within national frontiers and they were bound to encounter difficulty as soon as those

II

AFTER THE WAR

In my last lecture I discussed the system under which international trade grew in the nineteenth century. Today I have to consider the changes in that system as we pass across the great watershed of modern history, the war period of 1914–18, to more recent years.

I shall say little of the war period itself. The régime then imposed upon both economic organization within each country and on its diminished external trade was the result of the special needs and conditions of the war itself, the concentration of effort required to maintain the forces in the field, the blockade and the submarine campaign; and it ended with the conclusion of hostilities.

Nevertheless, there are a few things that need to be said about this war régime that are relevant to the enduring problems of later years.

In the first place the war was a kind of hothouse in which much that was otherwise growing slowly was forced rapidly into full fruition; it was a laboratory in which many experiments in State action likely to be needed for other purposes were carried out. The State control of economic activity in every sphere, imposed by the special needs of four years of struggle, was in many respects similar to that which may be required for other reasons, as the public insists upon the old self-regulating system, which is now less capable of effecting its adjustments, being supplemented by some form of collective regulation. While therefore the war system itself was ended in 1919, we shall find much that is instructive in its methods as State control requires to

be developed for other purposes in the future. So too the blockade and the submarine together, whatever their other objects and consequences, constituted from the point of view of economics the most complete form of economic protection the world has ever seen. Home industries were sheltered from foreign competition, and were enabled with this help to expand rapidly as they could not otherwise have done. On the other hand the public was deprived of the comforts and luxuries they derive from imports, and lost the benefit of low prices of which foreign competition assures them, while exporting industries lost their markets as completely as when they are opposed by the highest tariffs of foreign countries. The reactions of the blockade therefore will throw much light upon what we may expect in future if the present movement towards higher tariffs and economic nationalism continues. For good and ill alike the consequences are the same. Politically, the blockade and submarine were methods of attack. Economically, they were an extreme form of protection for the countries against which they were directed.

Secondly we must note that much of what we have been accustomed to ascribe to the war in our recent economic history was really due to developments in our economic organization which were accelerated and increased by the war, but not originated in it. And lastly, where the war was in fact the real cause it inflicted much deeper injuries upon some parts of our economic system than was at first realized and left enduring consequences which must be regarded as permanent factors in all the problems of our future.

I must emphasize the last two points, for they are the clue to the astonishing sequence of recovery and collapse in the last two decades, and we shall not be qualified to

forecast the future and its developments and meaning in any sphere of either economic or political questions unless we realize the true significance of the events of this recent period.

Before then I pursue my special theme of international trade, I will ask your leave to make a somewhat lengthy digression and to suggest to you what I believe to be the real key to the success and failure of our post-war efforts.

It is only too easy as we look back over nearly twenty years, with the troubles of the last six years vividly in our minds, to look upon all the efforts of post-war coöperation or negotiation as a long succession of follies and failures. Such an impression would be a profound mistake. The success of the first ten years' effort of recovery was as striking as its later collapse. It realized its objective, which was to rebuild the pre-war system. Failure came because that system was in several vital respects inappropriate to the new conditions and because it was too weak to resist and control the new and greater forces that had developed within our economic and political system.

This I believe to be the essential significance of the post-war period.

It is not surprising that in 1919 we should have failed to realize that we needed not only to rebuild on the old foundations, but to enlarge and strengthen the foundations themselves. The war itself was so shattering and stupendous an event that it seemed a sufficient explanation of all the distresses from which the world was suffering when it ended. Its obvious direct effects in material destruction, the diversion of the channels of trade, and the depreciation of currencies, were so great in themselves that they obscured more profound changes in the economic system and in society itself.

By comparison with 1919 the world of 1913 seemed to most of us a paradise from which we had for some years been excluded by the flaming sword of destruction It seemed a sufficient goal for our efforts to regain the paradise we had lost It was natural therefore that the first effort of the war should have been directed in nearly all countries, not to changing the foundations or the main structure of our society, but to repairing and rebuilding upon the old foundations and upon the familiar design This basic conception underlay the policy pursued in every sphere of action Let us look at each in turn

Material wealth had been destroyed and the normal renewal of capital plant—roads, houses railways and factories for peace requirements—had been interrupted The damage must we said be repaired, the arrears made up The system of elastic and intricate adjustment of supply to changing human needs by competition and moving prices had been impaired, and to a large extent replaced, by a vast mechanism of State control directed to the needs of war This State control must then, we said, be cut away, and the conditions under which the old automatic system could function again as in the past be reestablished Under *the stress of war finance currencies had broken away from* their metallic anchor, they had ceased to have any stable relation to each other or, even in a single country, to the commodities and services they could purchase, and the world had lost a stable medium of exchange for its transactions Well, the system which, it seemed in retrospect, had functioned with such miraculous efficiency, must, we said be restored currencies must be brought back on to the *gold standard,* and national budgets so reestablished that they could be kept on it The normal channels of trade had been diverted by the war and their resumption im

peded by the new tariffs which took the place of those most extreme forms of economic protection, the blockade and the submarine. These obstructions must as far and as rapidly as possible be removed and the private enterprise of merchants enabled to resume their familiar operations through their accustomed channels. The normal system of international lending and borrowing had been strained by the necessities of the Allied belligerents and remained burdened by the greatest of all international obligations, reparations and interallied debts. These two great debts must then be definitely determined and placed upon a basis which would enable investment for the normal developments of peace to be resumed. Some countries such as Austria, Hungary, Bulgaria, Greece, and Poland had been subjected to strains of so exceptional a character that they could not keep in step with the general progress of Europe to recovery. Combined action by the stronger powers must therefore be taken to help them to take their equal place in the general economy of the continent. In one respect only was it recognized from the first that the foundations of the pre-war system must be changed and enlarged. The outbreak of the war itself, and the character of the problems which succeeded it, showed that the traditional mechanism and methods of national diplomacy were inadequate to the needs of the modern world. A new instrument of combined international action, for the restraint of war, for the settlement of disputes, and for coöperation in common tasks, must therefore be established.

After the first needs of urgent relief therefore, the vast reconstruction effort of the post-war world was directed to the reëstablishment of the pre-war system with the one notable addition of the League of Nations. The removal of State control and the establishment of conditions fa-

vorable to private enterprise, the balancing of national budgets and the restoration of currencies and of the gold standard, the resumption of greater freedom of international trade by the reduction and stabilization of tariffs, the relief of social distress by the development of social services, on a larger scale but on familiar lines, the restoration of the system of foreign investment by the settlement of reparations and war debts, the reconstruction by combined action of the weaker countries and lastly the creation of a new international organization which would supplement, but would not necessarily change fundamentally, national sovereignty and the traditional social and economic system these were the objectives—and they seemed for the time the sufficient objectives—of the efforts of the first decade after the war

In spite of all that has happened since, those who took part in these efforts need not be ashamed of their achievement and they can scarcely be blamed for failing to see the latent weaknesses in the foundations on which they were building Never had the constructive intelligence of mankind been faced with so stupendous a task, never did it show such resources or achieve such results For a time the success seemed almost complete, and likely to be permanent Consider the position ten years after the cessation of *hostilities—in 1928* Everywhere throughout the western world pre war standards of prosperity had been surpassed, and the pre war system reestablished The average standard of living was higher than before the war International trade had indeed not fully regained its old volume and value but any loss was much more than compensated for by increased home markets There was an increase in unemployment in some countries, but in only one or two was the increase serious, and in those countries it was possible

to give maintenance at the expense of the community on a scale never previously known. Parliamentary systems of government, successful in the war, seemed to be justifying themselves in peace. Except in Italy there was no notable example of a previously free system breaking down and being replaced by dictatorship; and this was much more than offset by the establishment of free institutions in Germany, in Poland, in Austria, in Czecho-Slovakia and elsewhere. Currencies had been almost everywhere restored and linked again to the gold standard, and the world again had for both its internal and external transactions a stable medium of exchange. Some reduction had been made in tariffs, and the remarkable unanimity of the Economic Conference of 1927 promised further progress. Settlements, apparently final, had been made of both reparations and allied debts, and payments in accordance with them were being regularly made. The broken countries of Central and Southeastern Europe had been restored and put on the same general level as other countries of a similar type, new currencies being introduced and the finances reformed in Austria and Hungary, and large numbers of refugees being so successfully settled in new land colonies in Greece (and to a less extent in Bulgaria) as to make them an additional source of strength, instead of an expensive and disruptive element, in those countries. Capital was flowing freely (indeed, as the sequel showed, too freely) from capital-forming countries like America and Great Britain to those needing development in South America and elsewhere. Lastly, the new organ of international government, the League of Nations, in spite of the reservations in the support given to it by the constituent national States, had grown in strength and authority. To the original great powers among its members, Great Britain, France, Italy, and

Japan, had been added Germany The United States, though not a member, was cooperating regularly and on an extensive scale, and was contributing a further element of strength to the international system by the Kellogg Pact, and the time when the circle of the great powers in such a system would be completed by the addition of Russia (which has since happened) seemed not far distant The central political problem of Europe—the relations between Germany and its neighbors—was apparently well on the way to solution as a result of the rapprochement which was effected during the tenures of office of Monsieur Briand, Sir Austen Chamberlain, and Herr Stresemann, and found its expression in the Locarno Treaties Definite progress had been made with the limitation of navies, and the prospects for land and air disarmament seemed promising

Ten years after the war, then, in 1928, in spite of local distresses, some political menaces, and many difficult political problems, prosperity seemed to have been regained, parliamentary government to have been justified and reinforced, peace to be reasonably assured A little further progress along the lines on which such success had already been achieved, steady work in each country upon its domestic and social problems—and the future seemed to promise a civilization, perhaps not less stable and certainly much richer, than anything known in the last century

Then came the sudden and devastating collapse in the economic life of the world, in its financial system, in parliamentary government, in the new structure of peaceful international relations The world depression of 1929, the financial chaos of 1931, the new dictatorship in Germany of 1933 and its profound repercussions elsewhere, the diminished membership and reduced authority of the League as disputes and menaces alienated Japan, Germany, and

Italy, came in rapid succession; and a new race in armaments, at once a reflection and a cause of political tension, was inaugurated with the breakdown of the Disarmament Conference.

This tale of collapse, extending over the whole range of man's collective constructive efforts of the first decade after the war, cannot now be retold. But it is necessary to emphasize the central feature to be observed in every sphere of disintegration. It was the old system that had been rebuilt; and this system proved in some respects unsuitable to the new conditions, and not strong enough to control the new forces. The adjustment of each unit of human effort to the others with which it was interdependent required a general system strong enough to compel the appropriate response to each change. When any form of human activity, whether in the supply of goods or of services, was in excess in relation to others, falling prices must compel reduction; when it was deficient, rising prices must bring increase. But in one sphere after the other the system proved too weak to compel this response. When the ordinary working of the monetary system began to force down costs to redress a balance of payments, the resistance of organized economic forces was too strong for the system—rigidity in costs broke the gold standard. When financial obligations exerted their orthodox influence in increasing the debtors' exports and the creditors' imports, organized industrialists succeeded in utilizing the machinery of the State to stop the process by increased tariff barriers; this in turn made the financial obligations impossible of fulfillment, default followed, and the normal financial system was broken. Once again an organized economic force had broken the framework of law and obligation within which the normal adjusting process could alone

operate For similar reasons, national currencies, the international gold standard, the self regulating equilibrium in the balance of trade, national banking organizations, the international investment system, the enforcement of contracts—all the fundamental institutions of the normal régime—broke down one after the other And as they did so, as the impact of external events fell upon each national economy and brought new factors to which the appropriate corrective response was no longer forthcoming maladjustments developed throughout the internal system of each country as well as in international exchanges Idle productive capacity large scale and general impoverishment were the consequence Nor were the new forces which thus proved too strong for the old system solely, though they were largely, due to the war That system had depended for its full efficiency upon the competition of many small economic units, no one of which was strong enough to break the system or capture the instrument of the State itself The integration of economic units into large organizations, whether of combines or of large trade unions, developed forces too strong for the control of the old system

It would take me too far from my limited theme to attempt to describe the whole of the new system of more extended State action going far beyond the mere enforcement of law and order—a system largely rooted in the stronger economic forces which it now has to control I must now return to the special sphere of international trade From the confused and changing pattern of governmental action and control in many spheres, I must pick out and follow one thread It was necessary to look for a moment at the whole, to obtain a proper perspective for the part which directly concerns us My purpose, however, in

these lectures is not to describe and forecast the whole of the new structure of government and economic organization which is being evolved, but only that part of it which determines the form of external trade. To do this I need to isolate the relevant development in each successive period; and in this lecture therefore I must discuss the course of international trade and the policies affecting it in the first post-war decade.

When the war ended, the barriers to external trade imposed by the blockade and the submarine were removed. But for a time a host of other impediments prevented any rapid resumption of normal trade, the stoppage of normal foreign investment, currency dislocation, shortages of supply of what was required for peace needs, the absorption of shipping in repatriation and relief work, and so on. As some of these impediments disappeared, the effect was just the same as the sudden removal of a high tariff system would be. New industries had grown up behind the wartime "protection." When this was removed, they were threatened by ruin, and their workers by unemployment. To prevent this the different national governments were urged, and successfully urged, first by this industry and then by that, to bar out the new stream of foreign imports, sometimes by new tariffs, sometimes by prohibition. These new barriers were not erected as a part of any international plan for mitigating the dislocating effects of a return to pre-war channels of trade, they were set up by each government separately to deal with the particular troubles in its own country without regard to consequences elsewhere. More than that, each national government acted under the pressure of successive representations from particular industries without waiting to construct anything like a comprehensive national policy. As the process continued, how-

ever, each country began to receive protests from its exporting interests against the effects of other countries' tariffs and prohibitions The new protective system that grew up under these conditions was cumbrous, complex, and provocative Sentiment accumulated against it Attempts were made to simplify and reduce the barriers by international negotiations, the characteristic feature of which was that each country tried to get other countries to reduce tariffs while maintaining its own The negotiations at the great Conference of Genoa in April 1922 were typical This conference, which was composed of prime ministers, ministers of finance and trade of almost all the countries of Europe, and attended by officials from treasuries and ministries of commerce, was called partly to reestablish relations with Russia, partly to lay down the chief lines of European reconstruction As a part of this object a committee of officials concerned with commercial policy was set up to prepare an agreement for the removal of trade barriers It failed completely for a reason which was typical of all the subsequent failures of this period Each official was the prisoner of his own national system, each item of which represented a protection to some home industry which was supported by those who had secured its adoption He was responsible to ministers who were the prisoners of the groups of organized interests in their respective parliaments Each national representative therefore, while urging that others should change their policies, felt bound to defend his own and had no authority to agree to change it The greatest of all the difficulties in these negotiations was not that of a real conflict between divergent national interests and national policies but that there were no genuine national policies conceived as a whole but only a series of national systems improvised under pressure And neither

ministers nor officials were effectively masters of the national system so constructed. Always, as the negotiations proceeded, one felt that the dominant consideration in the mind of each national representative was not a conception of his nation's interests as a whole, mistaken or not, but a calculation of pressures to which the national government would be subjected by organized interests in the respective parliaments. Consequently the net result of the Genoa resolutions was rather to endorse and consolidate a system of trade barriers which everyone, looking at it as a whole, recognized to be injurious to world recovery, and those passages in them which recommended reductions remained as merely pious hopes without practical effect. And in general this was the experience of other conferences of this period, though a few organized at Geneva for more modest and specialized purposes secured the removal of some of the least defensible forms of trade obstruction.

Meanwhile, however, much greater progress was being made in restoring another part of the pre-war system on which international trade had depended, the restoration of the gold standard—which gave the world what was in effect a single and stable medium of exchange for its transactions—and of the financial system, which encouraged the flow of capital from industrial to non-industrial countries and provided the latter with the means of purchasing the former's goods.

In this sphere the difficulties, though great, were not insuperable. There was practically universal agreement as to the objective of policy. The influence of Central Banks and of bankers generally was strong in support of the system to which they had been accustomed before the war, and so far as action devolved on them they could take it without the handicap of pressure from strong political

forces A more difficult task fell on ministers who as a condition of making the gold standard effective had to balance their budgets which meant enforcing economies and increasing taxation But great as was the opposition they encountered it was less formidable than the organized resistance of industrial interests to the removal of tariffs Under the influence of the great Brussels Financial Conference of 1920 organized by the League of Nations bankers and ministers of finance in one country after another restored gold currencies and established *the conditions* under which capital began to move again freely from one *country to another*

Now as a counterpart to the liberalization of commercial *policies this return to the pre-war monetary and financial* system would probably have led to a great increase in world prosperity But with commercial policies still directed to excluding imports and therefore damming back other countries exports the attempt to restore a world currency and free capital investment was not only destined to ultimate failure it was bound to involve disastrous consequences of many kinds For money and finance are properly only the servants of trade They can assist trade to expand but they are useless if the expansion is deliberately stopped by other action Moreover success in restoring one half of the pre war system encouraged the most dangerous illusions Those who negotiated either reparation or allied debt settlements those who arranged large international loans like the Dawes and Young loans or floated large private issues for commercial enterprise in other countries did so on the tacit assumption that international trade *would expand in such a way* as to make the obligations falling upon the debtor countries possible of fulfillment No debtor country can in the long run discharge its external

obligations except by selling more than it buys. All these financial arrangements therefore depended upon creditor countries buying more than they sold; and the newly restored gold currencies depended upon the maintenance of an equilibrium in the balance of payments of each country, with due account of its external obligations.

The restoration of the old financial system, and of the gold standard, and the new financial agreements and investments, assumed and required the increased flow of imports into creditor countries. The orthodox working of the gold standard system would indeed have compelled this had it not been met not only with the resistance of the old tariffs but a commercial policy of resisting increases of imports by higher tariffs. This policy was, as we have seen, adopted by each country not as a part of a plan for the country as a whole but under pressure from the industries directly affected. Such a policy, unless reversed, was bound to break both the gold standard and the general financial system—as it ultimately did.

Meantime, however, a further, more skilful and persistent, and more nearly successful, attempt was made to restore greater liberty of trading as a counterpart to the already arranged—the prematurely arranged—freedom of finance.

In 1925 the League of Nations realized that sufficient progress had been made in the financial and monetary sphere to make an attempt in the sphere of commercial policy both opportune and imperative. Much had been learnt from past failures. The immense difficulties were realized. It was now clearly understood that long preparation was necessary, and that it was useless in the early stages to bring ministers or government officials, as representatives of national policies, into conference, since the result would

inevitably be a deadlock An influential preparatory committee was therefore appointed, consisting not of government representatives, but of experts—industrialists, merchants, economists, and also government officials After over a year's work in collecting information and special memoranda on every aspect of commercial policy, a great World Economic Conference, composed on the same principle, was summoned in 1927

The result was very striking This great Conference, composed of the highest and most experienced experts in the world—industrialists, merchants, economists, and officials alike—selected as authoritative by the respective Governments, agreed upon a report *nemine contradicente* which *recommended the most drastic reform of the national policies* of nearly all countries

This great Conference, the best prepared perhaps of all post war conferences, was brilliantly successful in its first objective, that of obtaining a practical program of reform carrying the highest expert authority

The even more difficult task, however, of translating this into governmental action, still remained

At first the prospects seemed favorable The moral effect of the Report of the Conference was very great It seemed likely that it would achieve a success comparable with that of the Brussels Financial Report of 1920 which was seen in retrospect to have had an enormous influence in transforming national financial policies

The main policy recommended by the Conference had been the general reduction of tariffs, with simplification and stabilization The method contemplated was threefold

(a) Unilateral action—each country acting independently in the hope or with the example of other countries doing the same

(b) Bilateral action—pairs of countries negotiating reductions on articles of special interest to themselves and extending the advantages of those reductions to other countries by virtue of the unconditional most-favored-nation clause, which I shall have occasion to describe and discuss a little later.

(c) Multilateral action—collective agreements being negotiated for the simultaneous removal of barriers and reduction of tariffs by all or many countries.

The first of these methods, unilateral action, had a substantial immediate success in arresting what had hitherto been a rapid upward movement of tariffs. Projects involving large increases were dropped or amended; new demands for tariffs were discouraged. Some, though not many, actual tariffs were reduced. By the end of 1927, however, this influence on unilateral action was diminishing. The countries which had refrained from tariff increases were disappointed that other countries had not made reductions. For each country tended to expect in return for the abandonment of its own projects (of which it was acutely conscious) not the similar abandonment of corresponding projects of other countries (of which it was imperfectly aware) but a positive reduction in systems already in force. The process slowed down.

The second method, that of bilateral action, also had a considerable success in 1927, "the year of commercial treaties." Numerous and substantial reductions were negotiated between pairs of countries, and these were then extended by the most-favored-nation clause. This process, however, also slowed down, for a reason which it is now important to consider.

The unconditional most-favored-nation clause is the pivot of the commercial negotiations of all this period. It

is a clause customarily inserted in all commercial treaties providing that each of the contracting parties shall receive as regards each class of dutiable commodity the benefit of the lowest rate of tariff accorded by the other to any country The clause thus leaves each country free to impose whatever duty it desires for each class of goods but on condition that it shall then be generally applicable It also gives considerable but not unlimited room for reciprocal negotiations between pairs of countries since they can choose the articles of special interest to themselves and lower the duties on these articles below the level applicable to other goods The clause has long been the traditional basis of British policy it was later claimed in its commercial treaties by the United States of America and in the post war period widely accepted even by continental nations accustomed though they had been to the principle of reciprocity It has undeniably under certain conditions very great advantages It secures equality undiscriminating treatment and by preventing a confusion of political and economic motives averts many causes of friction Moreover the two principles reciprocity and no discrimination logically alternatives can be combined under certain conditions A free trade or low tariff country for example can easily give and successfully claim undiscriminating treatment from countries which are negotiating reciprocal treaties *inter se* For the latter countries when arranging reductions of special interest to each other are content to accord these reductions to other countries if the latter s general policy is such as not to make the resulting situation impossibly unfair

But when countries with high tariff systems claim most favored nation treatment the result is rapidly to make reciprocal negotiations impossible For if two moderate

tariff countries can only negotiate tariff reductions *inter se* on condition that they accord these reductions also to countries whose general tariff system is much higher than their own, and who give them no advantage in return, two results are bound to follow. First, bilateral agreements for a reduction in tariffs will be stopped; and this in fact is what happened in 1928. Secondly, there will be a growing feeling against the most-favored-nation clause itself. Unless it is modified, it will be evaded until it can be denounced. We shall see later how, in the period of the depression, the evasions by new devices were so numerous and extensive as to make the clause an unreality, and shall consider the choice between the only alternatives, that of abandonment or modification.

In the meantime, however, in the period with which we are now dealing, the effect was to stop reduction of tariffs by the second method, that of bilateral negotiation.

This left only the third method, that of multilateral action by collective conventions to which all or many countries would be parties.

This method was attempted in a series of conferences, wisely starting with the less difficult objectives of removing other forms of trade barriers than tariffs (prohibitions, etc.). After certain limited successes had been thus achieved, an attempt was made on the central fortress of the tariff systems themselves.

This attempt failed for reasons which we must now consider. I need not emphasize the underlying difficulties of all tariff reductions. The private interests concerned in industries which have developed behind tariffs are better organized, more vocal, and more politically effective than the general public interests on the other side. The advantage to industries producing for the home market of main-

taining their national tariffs is much more obvious and direct than that of the exporting industries in having them removed So that one class of industrialists is asking its Government to retain or increase tariffs which it has the power to impose, while the others, the exporters, are asking their Government to persuade other governments to reduce tariffs It is obvious which is likely to be more effective

But apart from this inherent difficulty in all tariff reductions, there are further ones in regard to the method of multilateral action which was all that was left after the other two methods had failed for the reasons described There is the complexity of the negotiations, when a dozen or twenty different systems, each intricate in itself, have to be brought into one scheme And it is very hard to find a principle on which to proceed An equal reduction is justly resisted by low tariff countries, as leaving, or indeed increasing, an original inequality A reduction to a uniform level, for each class of goods is no less naturally resisted by high tariff countries the dislocation of whose economic life would on such a principle be much greater than that involved for others Compromises between, or alternatives to, these two principles are very hard to discover Every now and then someone chases a will of the wisp in the form of a so-called scientific principle of limiting tariffs to what is required to compensate for differences in costs of production in different countries Many countries have in fact professed to apply this principle as if it were a principle of moderation It is in fact mere nonsense For, apart from caprice or folly, no one ever buys anything from abroad except because he gets a better article at the same price or the same article at a lower price Abolish this difference and the whole basis of international trade is removed In fact, countries professing this principle have still retained

a considerable external trade, but only because they had the instinctive good sense not to apply it logically and completely. The main principle for reduction was therefore extremely difficult to find. And in the meantime the mere prospect of negotiations was a powerful inducement to countries to raise tariffs in advance so as to get a better bargaining position. In these conditions, therefore, an attempt was made to get a respite by agreeing upon a Tariff Truce—an undertaking not to raise tariffs for a specified period—long enough to enable a scheme for tariff reduction to be worked out without disastrous interruptions by increases of tariffs while the work was proceeding. This attempt looked as if it might have succeeded but for two misfortunes.

The first arose from the particular position of the issue of Protection and Free Trade as between the rival political parties in Great Britain. There was only one force which might have been strong enough to induce the protectionist countries of Europe to reduce their tariffs: the certainty that the retention of the great open market of Great Britain depended upon whether they did so or not. Now in the years succeeding the Economic Conference, the Government in England was first in the hands of the Conservatives, who were protectionists and were certainly not willing to promise to continue with free trade in return for any practicable reductions in European tariffs; and then in the hands of the Labour Party, who were pledged to Free Trade, and were unable to say they would impose protection even if other countries made no reductions at all. Under these conditions the one great motive force strong enough to induce countries with high tariffs to reduce them was not effective.

There was another handicap not less serious. Practically

all countries had sent members to the Conference of 1927 A number of them notably the United States were however unwilling to join the conferences of governmental representatives that followed with the object of concluding binding conventions And worse than that at the crucial point of these conferences the Hawley Smoot tariff with its large increases was passed by the United States Congress and—in spite of widespread and influential protests by many sections of the American public opinion—was ratified by President Hoover

To us at the time this refusal to use the power of veto seemed the decisive factor in the whole effort of world reconstruction It was not that for there were other forces at work which would in any case have rendered all our efforts abortive But it was at least an important factor in bringing to failure the actual Tariff Truce Conference and the negotiations immediately connected with it

In any case however as we now see all such efforts were destined to failure It is possible—though even this is doubtful—that a wholesale scrapping of barriers to trade as early as say 1924 when the Dawes plan for reparation and the Dawes loan were arranged would have given such elasticity to the world s economic system as to enable it to adjust itself to the new conditions and to the new financial obligations that had been contracted But by 1930 it was too late Latent but potent disruptive forces had been generated which were destined to shatter the whole system on which the expansion of international trade depended—the gold standard the mechanism of investment the observance of contracts etc —and to drive every country back to policies of economic nationalism Nothing in the way of tariff agreements in 1930 could have withstood these forces We were like an army struggling to capture a strong but not

impregnable fortress, ignorant of a mine under our feet and suddenly, at the crisis of our fortunes, blown to pieces by its explosion.

The first decade of post-war reconstruction, successful to all appearance in almost every sphere of effort, had seemed likely at one time to crown its efforts by establishing the conditions of a large expansion of external trade. Before this last success was achieved, it had become evident—first in the depression that began in the autumn of 1929, then still more in the financial crisis of 1931—that we had rebuilt on insecure foundations; and the whole structure, which had seemed only to need a coping stone, crumbled before us.

We shall have, in the next lecture, to trace the course of international trade in the disastrous period that opened with the depression of 1929.

III

DURING THE DEPRESSION

I NOW have to consider international trade during the period of the economic depression and the financial crisis, to indicate how it affected, and was affected by changes in other parts of the economic system, and the effect of governmental policies both before and during this period.

No picture of international trade can be intelligible except in the perspective of the depression as a whole. I cannot, however, attempt in the brief space of an hour to give my general view of the real meaning and significance of this disastrous and chaotic period. Those who are interested will find my own conception of it explained elsewhere. I can only now mention briefly those elements in it which throw special light on the future of world trade.

The first thing to emphasize is certainly that the chaos of these years is due to no single cause but to the coincidence and interaction of many different causes each with its chain of consequences. Let me mention some of the most important of these.

I believe, for example, that there was bound to be agricultural depression at about this period of history, even if there had been no war, no financial crisis and no industrial depression except what would have resulted from the reduced purchasing power of agriculturists. Several causes contributed to this. As the average man's income increases, he increases his expenditure on manufactured articles or upon a more skilled treatment of his food after it has passed out of the hands of the agricultural producer. His taste for luxuries may develop indefinitely, but his ap

petite for the stable foods is not similarly elastic. Indeed the consumption per head of basic foods like bread definitely goes down as more luxurious foods take their place. Except, therefore, in the countries whose population is near the margin of starvation, like China or India, consumption of the main products of agriculture does not increase more rapidly than the population. This is not all. At the beginning of this century the traction power of the world, in spite of rail and water, was mainly based on grain; now it is based on petrol. The internal combustion engine has replaced the oat-consuming horse. In addition, mechanization applied to agriculture has now increased greatly the amount of grain produced per unit of human effort. These factors were bound, in the absence of a large increase in the consuming population, to lead to a surplus of agricultural produce and in time to compel a large transfer of men from the land to urban occupations. This tendency was indeed mitigated by some increase in population. But in countries with the greatest purchasing power this increase has long been slowing down. Indeed, if we are looking to the future either of agriculture, or of world trade as a whole, the change in birth rates is a fact of cardinal importance. In countries with great food markets like the United States and Great Britain the population is destined soon to be stationary, and at no distant date to suffer an actual decline. Unless therefore consumption in countries like China and India increases, the total production of wheat, oats, maize, and rice cannot largely increase, and it is difficult to see how such countries will be able to afford to consume much more unless they produce more food themselves. Now the whole equilibrium of world trade was in the last century largely maintained, the main basis for the expansion of that time provided, by the exchange

of food produced in countries like Canada, Australia, Russia etc , for the manufactures of other countries Their economic development was dependent upon ever in creasing markets in countries like Great Britain It was assumed that such markets would expand indefinitely They will not expand but contract Agricultural countries must therefore, reduce their exports, and they will have to absorb the agricultural workers thus rendered superfluous, *as well as those displaced by mechanization by developing* their industries The whole course and character of trade will in the next half century be profoundly affected by this fact

In addition to the agricultural depression, with the effect upon industries of the reduced purchasing power of agri culturists, there was also of course in 1929 the downward turn of an ordinary industrial cycle of the familiar type On this I will not dwell, for, so far as it was due to causes which operated also in the last century, it throws no special illumination on the future of world trade

But what chiefly converted this depression into one of unprecedented depth and range was a failure in the world s financial and monetary system, and since this will have much more enduring consequences I must say a little more about it I must, however, take a short cut through the tangled maze, choosing the course most appropriate to my theme

The war left huge governmental debts, both national and international, in the belligerent countries, together with a claim for reparation from Germany which burdened her finances in the same way It also drove most of the *allied currencies off gold, and left them on a paper or* ' managed basis, with every variety of changing values in relation to each other and in purchasing power At the

same time the blockade and the submarine forcibly restricted international trade to small dimensions, and as we have seen created a situation in which there remained in the post-war period the most formidable impediments to the expansion of the exports of debtor countries, which is the only method by which in the long run they could meet their obligations. For a time, however, if there are willing lenders a country can both buy from abroad and meet its financial obligations without corresponding earnings from exports by resorting to one form or another of borrowing, and, if it has gold, it can ship this too in settlement.

The astronomical figures of war finance, an assumption that Germany would be able to increase her exports to an extent that proved impossible in view of the tariff policy of creditor countries and other circumstances, political passions and the financial exigencies of allied countries with war damage to make good, led to a demand for reparation far in excess of any practicable surplus that Germany could attain in her balance of trade. The political difficulties resulting from a failure to pay supplied a powerful motive force to arrange large loans which would make it possible for her to pay sums as large as the minimum which her creditors could be got to accept as satisfactory. Such loans were arranged in connection with the Dawes plan of 1924 and the Young plan of 1929. These loans were used in part to pay reparation, in part to finance useful internal expenditure. This expenditure was not, however, such as to enable Germany to earn the surplus in her balance of trade required if she was to meet her obligations in respect of reparations and of the service of the new loans when the capital itself should have been exhausted. The loans therefore remained as a dead weight on her future economy.

The interallied debts also representing no currently productive assets were a burden of a similar kind on the economy of the countries owing them though this burden was relieved for the time while they were receiving payments from Germany This was not all however The successful flotation of the Dawes loan the revival of confidence which followed it and the regular payment of reparation in the immediately succeeding years encouraged a great expansion of loans from creditor to debtor countries Many perhaps most of these loans were recklessly negotiated and devoted to a large extent to unproductive purposes and the borrowing countries mainly raw material and food exporting countries like those of South America and Australia could only hope to avoid serious trouble when the loans had been expended and the interest on them remained to be paid if they could greatly increase the volume and value of their exports This for the reasons already indicated they were ultimately unable to do

Meantime especially during the period 1924–28 the trade of the world had come to be based on a foundation of foreign lending which in the nature of the case and especially in view of the defective character of many of the loans could not continue indefinitely That is a large proportion of the goods sold were sold to countries which could not have found the foreign exchange to pay for them had it not been for the inflow of money from the loans This inflow came the more easily and the ultimate consequences were not realized because the individual purchases of goods were by individuals who might be solvent and appear to themselves and to others to have every prospect of remaining so While foreign money was flowing into their countries from the loans they had none of the difficulty in

obtaining foreign exchange for their national currency which they were bound ultimately to experience when the loans were exhausted.

And another factor soon became operative. While European currencies were off gold, there was no obligation to give gold in return for currency to all comers and therefore no imperative necessity to maintain gold reserves. The need of European countries, after the devastation of the war, for foreign imports, and other causes, led to a great outflow of gold to America. When the gold standard position was reintroduced, gold reserves were necessary again. Under these conditions, and in view of the extent to which gold was "sterilized" in the countries to which it went, there was a scarcity of gold, and a strong competition for it. Countries which had just reëstablished a gold currency, after great efforts and sacrifices, found their gold reserves running out and, fearing they would be forced back on to a paper currency, made desperate efforts to preserve them. And everything they could do increased the economic depression, and restricted trade, especially international trade. Even when they took only the first orthodox remedy, of raising the discount rate, and thus raised interest rates generally, this increased the costs of business, made industries on the margin of profitability unprofitable and so restricted production and employment. But raising the discount rate did not achieve its normal result of attracting short-term capital and so relieving the strain on the gold reserves, for the investor was more afraid of losing his money by depreciation or default than he was attracted by a somewhat higher rate of interest. Other steps were necessary. Some countries, under this fear for their currency, did everything to get exports sold at any price. This had the effect of reducing world prices generally, of spreading deflation, of

ficient to meet its payments in respect of past loans. And every creditor country was aiming at a *positive* balance of payments, that is, at selling as much as it bought or at least at leaving a smaller difference between the two than the amount it expected to receive from its debtors. Both were attempting this by means which, at every stage, reduced trade and especially external trade. And since the total of what all countries sell must obviously be equal to what all countries buy, the process was bound to continue indefinitely, reducing international trade all the time, until policy was changed, or debtor countries were forced into default. I shall return a little later to what is involved in the balance of trade and payments, but this short summary is sufficient for the moment to indicate one of the principal forces in operation in the period from about 1929 onwards, when foreign lending fell off, until 1931 when wholesale default, in one form or another, began to spread throughout the world.

One of the chief forms of default, resulting from the causes thus described, was the fall of currencies from gold, that is, the failure of Central Banks, or other currency authorities, to fulfill their legal obligation to give a fixed amount of gold on demand in return for a given amount of currency.

This important epoch in post-war history, the fall of currencies from gold again after their return to it in 1923 and the following years, began with the fall of sterling in September 1931. I do not propose to discuss further now the causes of that fall, the ultimate weakness in the British economy caused by the return to gold at too high a ratio in 1925, or the immediate causes in the withdrawal of liquid foreign money as panic spread in the summer of 1931. I am now concerned rather with the consequences.

I was at the time representing the British Government at the *Assembly of the League of Nations* and it fell to my lot to make the fateful announcement there The blow was a staggering one Everyone felt that a main pillar had snapped in a world structure already strained and weakened and that the repercussions would be disastrous and far reaching

These were immediately visible Not only did all other parts of the British Empire leave gold—India and Australia besides Canada which had already imposed an embargo and all the colonies—but the Scandinavian countries Japan and other countries followed suit As South American countries had left gold earlier the Russian rouble had lost value Spain had not stabilized since the war and China remained on silver the gold standard remained in less than half the world instead of prevailing over nearly the whole

This new crisis threatened one country after another with the dangers of having its currency forced off gold or of defaulting on its foreign obligations or both and the measures taken in consequence by each of them were *in every case such as to deepen the depression* This was equally true when a country was striving to remain on gold and when it ceased to do so In the former case the obvious action was to strengthen the balance of trade by new tariffs or prohibitions against imports which reduced the world market brought down prices and provoked retaliatory measures which continued the same process

But the result was no less disastrous when the struggle to remain on gold was abandoned When sterling fell for example since the British market is so large a part of the whole world market and the price structure of international trade is so largely in terms of sterling the effect was not so much to increase sterling prices as to reduce gold

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prices, though not of course to the full extent of the gold depreciation of sterling. Unfortunately this further pressure on prices chiefly affected food and raw materials which had already suffered most, and it was the countries that produced them which were already in the greatest danger of defaulting. Moreover, all gold countries were adversely affected. French exporters, for example, found they could get less francs for their goods, and since their costs were in francs all industries on the margin of profitability had to cut down production and employment. Moreover, the new tariffs imposed as a help to maintaining the gold standard were retained and usually increased after it had been abandoned, partly because vested interests had been created, partly in order to diminish the risk of the managed currency depreciating indefinitely.

In addition a new, and even more disastrous, force came into operation. As panic spread, and distrust of all the main institutions on which both national and world trade depend became general, men began to hoard in what seemed the safest—and sometimes the only safe—form, that of gold. I remember asking at the time whether depression was universal in America and extended to every industry, and I was told that in one case demand exceeded supply —the demand for strong boxes to guard gold deposits. The effect was to make gold scarce, to increase its value and again therefore to force down the prices of commodities in terms of gold. Meantime the fear of every business that its creditors might default led to anxiety as to whether it would itself be able to meet its obligations; there was, therefore, everywhere a tendency to prefer "liquidity" to the extension of enterprise on which employment depends. Current deposits in banks were preferred to investments in business not immediately realizable; and when distrust

in the banks spread, deposits were liable to be withdrawn and converted to gold, with a consequent strain on the banking system

This process of "deflation" was the most disastrous characteristic of the whole crisis For though it was primarily due to international causes (the breakdown in the system of international obligations and lending the scarcity, in relation to a demand increased by panic, of gold, and consequent fall of gold prices), and was primarily expressed through a restriction of world trade and a reduction of its price structure, its most fatal effect was to dislocate the internal economy of each country The extent of productive activity and of employment depends upon profitability, upon an excess of obtainable prices over costs Costs tend to be rigid, and under modern conditions more and more rigid A sharp and prolonged fall of prices therefore while sometimes reflecting a reduction of trade due to other causes, spreads depression in radiating circles of reduced employment and purchasing power And serious as was the reduction of external trade, and the immediate consequences of the loss of the purchasing power of those directly affected by it, this was of immensely less importance, as the crisis spread, than the disruption of each country's internal economy by deflation For in every country, even one which depends on external trade as much as Great Britain, the internal trade is immensely greater—in most cases many times as great It was deflation' which was the main factor in breaking the general system and main institutions on which the economic process depends In every country it struck, and broke, what was weakest in its structure—the English currency, the American banking system, the French internal balance between industry and agriculture, the new parliamentary system in Germany

The dislocation of the internal economy of each country was thus immensely more serious than the loss of its external trade.

It was then the financial and currency crisis of 1931 which turned the previous exceptionally severe depression into one of unprecedented severity in its depth, range, and duration; and it did so because it was, in essence, not the downward movement of a cycle but the breakdown of the very *system* which in other depressions always compelled corrective responses to the changes taking place and ultimately brought a remedy before the whole structure of society was threatened with collapse as it has been this time.

For about a year economic policy was little more than a *sauve qui peut* by every country. Each directed its policy to securing some protection against what it feared most. And in each case its fears were determined by its own previous experience, with little regard for that of other countries. The currency history of this period is in particular an interesting example of the fact that all countries remember their own experiences vividly, and apply their apparent morals even in completely different circumstances, and are very little influenced by what has happened elsewhere—or by the inevitable consequence upon the fortunes and policies of others of the action they take themselves. Thus we find each country valuing a maintenance of its gold currency in precise relation to the extent of its depreciation in the first post-war period. The German, who had seen his currency lose all its value in 1923, looked upon a departure from the fixed gold parity of the German mark as the end of all things. In July 1931, when the German exchange fell a few points for a few days, the furniture shops were emptied of their contents by panic-stricken purchasers who wished to exchange what they thought a doomed cur-

rency for tangible goods—any kind of goods. Bruning in 1932 preferred, to a depreciation of the mark, a policy of violent deflation which greatly increased the forces of discontent, which led to the subsequent change of régime, and later every device of control of currency, whose real value had fallen far below its nominal gold parity, has been attempted to avoid an open admission that that parity has been lost. France, who had seen four fifths of the gold value of the franc lost, has preferred a long and severe depression to any further change in its gold content. But, never having suffered the utter chaos of the German currency, she may perhaps—though this is doubtful—prefer devaluation to an intricate system of exchange controls. Great Britain, having seen her currency lose some half of its purchasing power, but not more, endured some years of deflation in order to maintain the restored pound. But there was a limit to the price she was prepared to pay and when the pound fell, she quickly accommodated herself to the new situation, and while taking certain precautions against the risk of extreme depreciation was never greatly afraid of it. The United States, having a gold currency intact till 1932, and never having in recent history experienced the evils of inflation, allowed her currency to fall while possessed of immense gold reserves, and later as we shall see, intentionally forced down the gold value of the dollar in order to secure an internal rise of prices.

But, whatever the difference in the objectives of national policy and the difference in national measures adopted, they all, as we have seen, had one feature in common—they all reduced world trade. In the first shock of the pound's fall in September 1931 it would certainly have been hopeless to attempt any form of international action to guide or limit the separate action of governments concen

trated on defending what seemed the weakest points in their own systems. But in the course of 1932 the first crude adjustments to the shock had been made, the general situation could be seen as a whole, the disadvantages of the universal recoil to economic nationalism had become apparent. Things had settled down enough to make a world conference seem practicable; they were sufficiently unsatisfactory to make it seem worth while.

It was in these circumstances that the great World Conference of 1933 was decided upon. It was elaborately prepared, technically by meetings of specialized experts in financial and economic committees at Geneva, politically by consultations between European statesmen and by a series of visits of prime ministers to President Roosevelt at Washington.

Then came the next great disaster. While the British Prime Minister was on the Atlantic the dollar (which had temporarily been off gold in March but had quickly been brought back) fell again, and this time it was evident that it would not be restored. The fall was perhaps not as strongly resisted as it might have been; but it was certainly not deliberate or intentional. It was decisive for the fate of the Conference.

Had the dollar fallen when the question of a Conference was first being discussed, the proposal would certainly have been postponed until the first shock of this great event had been absorbed. It was obvious that no Conference could have usefully met a few months after the fall of the pound. Nearly a year was wisely allowed to elapse before a decision to hold one was taken, and then nearly a further year was allowed before it was actually to meet. The fall of the dollar was an event of comparable magnitude and similar character. No conference should have been at-

tempted till 1934 But by April 1933 public expectation and hopes had been centered on the great Conference Its cancellation would have created a new wave of distrust and started a new depression It *would also have been* politically very difficult to agree upon a postponement as the relation between currency and economic policy was imperfectly understood in America who would certainly *have resented a change of plans which would seem to place* the responsibility with her for the disappointment of the world s hopes and expectations

Nevertheless postponement would have been the best course For without some form of currency stabilization no tariff negotiations were possible If the dollar had held some system of provisional and conditional stabilization *between the gold currencies and the sterling area* currencies which after nearly two years had recovered from the first shock of leaving gold might have been practicable But the new dollar position was incalculable and while there remained complete uncertainty as to the ratio between the principal currencies no economic negotiations of importance—certainly no tariff agreements—were possible The *reason is obvious Suppose* for example Great Britain and France could arrange reciprocal tariff reductions to their mutual advantage France could never make an agreement to this effect since for all she knew a future fall in the English pound might rob her of all the benefits of the English concessions while being tied to a fixed parity to gold she would still be giving the agreed advantages to *English imports Currency chaos* therefore wrecked the great conference as it must wreck any great economic conference when it exists

The sequence of later events must be briefly summarized In October America embarked on her policy of

deliberate currency devaluation. Whatever might be the internal effects of this policy, its external consequences were necessarily disastrous. Further deflation was forced upon the gold currency countries. France, Switzerland, Holland, and Belgium, which had all been slowly recovering, were plunged into a new depression, while countries with currency restrictions, like Germany and Italy, were forced to elaborate and increase them.

There followed a period of intensive economic nationalism—a rapid, elaborate, and complex growth of impediments to imports, in the form not only of tariffs, but of prohibitions, of quotas, of exchange restrictions. The distinctive feature of this period was that the main impelling motive for the erection of trade barriers was not the customary desire to protect home industries but the desire to protect currencies—to keep them on the gold standard, like the French group, or to keep them nominally at a higher gold value than they were really worth as in Germany, Italy, and most of the countries in central and southeastern Europe.

It seems amazing, when the cumulative effect of all the impediments to trade are considered—the tariffs, increased in real effect by the fall in prices, prohibitions, quotas and, above all, restrictions on the use of currency for the purchase of foreign goods—that international trade continued at all. It is an astonishing and conclusive proof of the vitality and essential value of international trade that, with all these difficulties, it never fell by more than about one-third in volume as compared with its pre-depression level. You will often see very different statements. We are often told that international trade fell not by a third, but to a third, or even to a quarter. But this was only in gold value, and in a world of mostly managed currencies, and with gold

prices fallen to half, that is a completely misleading method of measurement The truth, and the astonishing truth, is that world trade never fell to less than two thirds of its pre crisis levels—and is now up to more than four fifths

The latest period, in which we still are, is one in which world trade has been slowly forcing its way back to something approaching its earlier volume, not by the removal, or even the general reduction, of tariffs, not by the removal, or even the general reduction of exchange restrictions, but by the superimposition of yet another complicated system There have been bilateral, reciprocal trade agreements, barter arrangements under which large quantities of commodities have been exchanged between pairs of countries and above all a new currency system of 'exchange clearing' to which I shall refer in my next lecture Still further complexities were added for the unfortunate exporter and importer, but on the whole this last addition to the structure of official negotiations enabled more trade to develop than would otherwise have been possible

I have emphasized in this lecture two developments of recent years, because they are the two principal factors which I think we must take into account in forecasting the system of the future, and in determining the policy by which to seek an enlargement of trade, first the growth of new restrictions upon imports as a result of currency instability and currency fears, and secondly the building of a new "exchange clearing" system out of these currency restrictions, for the purpose of increasing external trade, not with the world as a whole, but with selected countries

It is with this as our starting point—perhaps I should even say with this as a foundation—that we have to build the system of the future

IV

PRINCIPAL FACTORS IN THE PRESENT SITUATION

THE sketch of recent economic history which I have given in my earlier lectures, slight and inadequate as it has been, may suffice to give the background of our present problem.

I propose in this lecture to summarize the principal factors in the present situation which will determine the future form of international trade, and in my last and concluding lecture to suggest the elements of a constructive policy which I believe will give us, under modern conditions, the best prospects of securing an expansion of international trade.

In the first place I believe that we must assume that governments will participate more actively and more intimately in economic enterprise than before the depression. In some cases, but these will in any near future be exceptional, the Government will take control of the whole economic system of the country. In most other cases, as in my country and I suggest probably in yours, there will be a mixed system. A large section of economic activity will be taken out of the sphere of private enterprise and entrusted either to the Government or to public corporations, such as the London Passenger Transport Board and the Electricity Board in England. The remainder will be left to private enterprise, but to a private enterprise regulated and controlled by public authority and adjusted to a conception of national economic policy as a whole.

Different countries will try different economic experiments; and on the whole they will subordinate the inter-

ests of foreign trade to the interests of these experiments

We have in the second place to consider the consequences upon the course and character of foreign trade of the great progress in industrial technique These are of two opposing kinds On the one hand the natural unit of production tends to increase and large scale production tends to require markets larger than those compressed within national frontiers and therefore to compel an enlargement of external trade On the other hand however it is much easier now than before for small or less advanced countries to attain a tolerable standard of living with only a small dependence on imports I believe that in the long run the first of these effects will result in a new extension of foreign trade but in the short run while fears of war or currency chaos prevail the second will be more potent

I come now to a third consideration

Trends of Population

Economists have only recently begun to examine the economic effects of the astonishing changes in population trends of the post war decades They have been so long dominated by the ideas of Malthus and by the fear of an increasing population pressing upon the margin of subsistence that they have been blind to the much more imminent prospect as regards western peoples of a decline in population coinciding with an increased productive capacity I can only illustrate what is happening by a few examples In Great Britain the population is now almost stationary while the change in age distribution—a stationary total being composed of more people above the age of reproduction and a smaller number below it—has already made an early decline inevitable How important this change is may be shown by a few figures In four or five

years' time the population, which now numbers about 44,-800,000, will begin to decline. In a quarter of a century it will have fallen to under forty million, and what is much more important, the number of children under fifteen will have fallen (in round figures) from ten million to five million. In the course of the 1970's the population will fall to two-thirds of its present size and there will only be half as many people as at present under the age of forty-five. A similar tendency is observable over the whole of western and northern Europe. Even in Italy and Germany the movement, while it is coming later, appears to be ultimately inevitable. In the United States it is estimated that, with present birth and death rates, the population, while still likely to increase until about 1980 (when it should reach a level of 155 millions as compared with the present 125) will then decline progressively. Incidentally it may be noted in connection with this figure that the United States Bureau of Agriculture has estimated that the United States can provide within its own boundaries food for a population of 300 millions without any further improvement in the technical processes of food production. In larger sections of the rest of the world—Russia, India, and Japan—the tendency is however upward, and may be greatly increased by a fall in the rates of mortality.

What, in the briefest terms, are likely to be the main economic effects of these changes in population?

First, we of the western world may relegate to a remote future any fears of food shortage, which if it ever comes will be the result of the successful seizure of our resources by other increasing races of mankind.

Secondly, we are faced with an immense problem of transfer of occupation. There must be a large movement

from the land into industry, into the distributive trades, and into personal services of all kinds. Food producing countries like Canada, Australia, and the Argentine, whose economy has largely developed on the basis of the apparently illimitable opportunities of exports into countries like Great Britain, will be forced to industrialize themselves to a much greater extent than at present. This will reduce and change the character of the exports which countries like Great Britain will be able to sell them.

Thirdly, a stationary and declining population, first in countries like Great Britain, and later in the United States will make the adjustment of industrial production to demand much more difficult. In the expanding nineteenth century a temporary excess of production of any of the stable industries would be soon overtaken by the increased demand of a larger population. Now there will be the much greater difficulty of adjusting such industries to a stationary or declining demand. The need to develop and exploit new forms of demand, and of transferring capital and labor to the industries that can supply it, will be intensified. And above all, the difficulties of the transition will immensely increase the incentive to national planning, and government control of all kinds. And further government planning of this kind will, as we have seen, profoundly affect the conditions under which external trade will develop.

Fourthly though nationally planned economies will involve a control of foreign investment—which will in any case be restricted for some time to come by the investor's recent experiences—there will be a little later a strong incentive, *resulting from the factors I have just been describing*, to develop countries whose standards of living and

consumption are low, of which the most important example is China. A new period of large foreign investment, encouraged by governments and directed towards less developed countries, may be expected, not immediately but in a not very distant future.

I have only been able to indicate the problems—which urgently need further study—that will result from population changes, and I must now turn to other factors.

Currency

I now come to a whole group of problems that turn upon currency. Here too I must be brief and summary. It has been my purpose, in my sketch of recent history, to show that currency considerations have played a rôle of dominating importance in establishing the conditions under which external trade now has to take place. The great bulk of the existing impediments consist of either foreign exchange restrictions or tariffs, quotas, etc., imposed for the purpose of protecting currencies. We must attempt, however, to separate out the more permanent from the merely temporary effects of currency difficulties. I suggest that a few conclusions emerge from our experience of the recent crisis.

There are several abuses which have developed from the working of the gold standard under modern conditions which the leaders of industry and trade rightly resent and will not, I think, be prepared to tolerate in future.

In the first place they realize that, while in the nineteenth century the changes in Bank rate and rates of interest were made mainly in order to adjust and correct real changes in the balance of trade, they have recently been concerned more with the dislocating effect of rapid mass movements of short-term capital. Speculators in a cur-

rency, persons with short term capital at their disposal, or investors selling and buying securities on different markets, have moved immense masses of money from one country to another, with the most important consequences to balances of payments and currency reserves Trade and industry will, I believe, insist on being exempt in future from the dislocation of their normal business through currency measures resulting from such causes

More generally, now that the devastating effects of internal deflation have been experienced and realized, I believe that the leaders of trade and industry will insist upon being safeguarded against its recurrence in a drastic form They will subordinate the advantages for external trade of stable exchanges to the advantage of avoiding a depression of internal prices by currency measures Lastly, they have realized that a rapid and extensive fall of prices for any reason, for example a shortage of gold in relation to demand, is equally disastrous They will insist upon some system which will ensure a reasonable measure of stability in the general level of prices

It follows in my view that the restoration of an effective gold standard over the greater part of the world will depend upon the central banks and governments being able in cooperation so to manage it as to secure a reasonable stability in the general level of prices, and being able to eliminate the dislocations caused by immense mass movements of liquid capital, or changes of investment And I believe that, in the long period which must in any case elapse before these conditions can at the best be assured, any stabilization of currencies must be provisional and conditional At the same time, at least such a measure of stabilization is highly desirable, both in order to secure a practicable medium of payment for foreign trade and in

order to give a basis upon which commercial treaties can be negotiated. I shall make specific proposals on this point in my concluding lecture.

Balance of Trade and Payments

I come now to a whole group of questions that turn upon the Balance of Trade and of Payments.

Under the nineteenth-century system these looked after themselves. Any temporary disequilibrium resulting from changes in the balance of trades between different countries was corrected by the orthodox operation of the gold standard.

Under recent conditions this system has broken down. Through apprehension as to their currencies, governments have been intensely preoccupied with their Balance of Trade and have thought it necessary to supplement the action of central banks, through the discount rates, by the much more potent measures which are at the disposal of governments for the control of external trade.

In effect this preoccupation has taken the form of practically all countries trying, with the aid of governmental action, to sell more and buy less. Since in the world as a whole total sales and total purchases must obviously be equal, these efforts were necessarily bound to conflict and defeat each other; and since it is much easier to stop imports than increase exports, the net result of all these efforts has necessarily been to diminish foreign trade. It is of vital importance therefore to consider what we really mean by a balance of trade and of payments, and what is the right attitude of governments towards it.

It is not true of course that a country's exports and imports of goods, or even of goods and services, must always be equal to each other, or that a change in one will neces-

sarily be followed by an equal change in the other There is however, a very intimate connection between the two And what is true, without any qualification whatever, is that the total of a country s payments to the outside world —whether for goods or services received, or in foreign loans or investments or interest on past borrowings or any other purpose—must exactly equal the total of its receipts in payments or in credits from the outside world in the same period We shall perhaps see the position more clearly by taking an actual example I will take the estimated balance of payments of the United States for the year 1934 (the information for the complete year 1935 not being yet available) In this year her exports amounted to 2 132 millions of dollars and her imports to 1 655 millions there being thus a credit balance of 477 millions Adding the other net items the balance of payments was as follows

U S A Balance of Payments 1934

NET FIGURES IN MILLIONS OF DOLLARS

Debit		*Credit*	
Shipping	35	Exports	477
Tourist expenditure	220	Interest and dividends	327
Immigrant remittances	124	Securities sold	386
Gold silver, and currency imports	1,351	Miscellaneous	540
	1 730		1 730

Now the totals on the two sides of this account are of course equal—and must be equal Whenever there is a change on one side of the account there *must* be an equal change on the other side If, for example, imports are re

duced by tariffs or any other cause, *either* an item on the same side of the account must be increased or a new item added, *or* an item on the right side of the account must be reduced. This is true without any qualification. In practice what it means is that when a country's imports of commodities are reduced it must either lend or invest more abroad, or it must import more gold and silver, or it must reduce its exports. There is no escape whatever from this position. It leaves several choices open to a country, of course, in particular that of increasing foreign investments or alternatively suffering a reduction of exports. But some combinations are simply impossible. No country can sell more than it buys and at the same time receive as much in respect of past foreign investments as it continues to lend abroad. A realization of this arithmetical necessity by all countries and its practical application in policy would have saved the world incalculable injury in the last decade. The net conclusion is not, in my view, that countries should be content to leave trade balances to regulate themselves as in the past, for modern conditions, and in particular the pressure on governments to exclude imports by tariffs for protective purposes and to subsidize exports, will make any such attempt both wasteful and provocative. What I think they should do is to study their balance of payments and then aim not at a *positive* balance, which it is impossible to achieve, but at a *balance;* and that when they have decided the main kind of balance they desire to achieve, and the amount and kind of imports this involves, they should definitely encourage such imports just as much as they discourage others.

You can fight against many things in this world, with some hope of success, but it is useless to fight against the laws of arithmetic.

Foreign Investment

I must next make a few comments on the position of foreign investment In the great era of expansion the foreign trade of the world depended to a very great extent upon a continuous stream of new capital from countries which had reached a relatively advanced stage of industrial development, like Great Britain, to rapidly developing countries like the Argentine, Australia, and Canada, which in effect bought British manufactures partly with the proceeds of their exports and partly with capital lent from Great Britain The United States during this period occupied a special intermediate position of great importance On the one hand it was highly industrialized, and in the eastern states was a capital producing country On the other hand its needs for development were so great as to absorb all the spare capital available from the eastern states and more Right up to the war, therefore, the United States was a capital importing country The position then changed suddenly and dramatically After the war the foreign trade of the world came to depend very largely indeed on enormous loans and foreign investments from America, without which the external world would have been unable to buy American goods, and American exports would have been restricted to very small dimensions This was the situation in the period 1924–28 The depression beginning in 1929, and political instability in addition, led to a sudden stoppage of this foreign investment, and the consequent disequilibrium in the world s balance of trade was further greatly increased by the payments due in respect of past loans This gap in the balance of payments was the principal cause of the financial crisis of 1931 which converted the economic depression into a world disaster without prece

dent in economic history. Since then foreign lending has almost ceased, obligations from the past have fallen into default, and trade is now either internal or is carried on almost entirely on the basis of cash or barter or short-term and specifically allocated credits. And in addition to the disillusioned creditors' reluctance to lend again, government action in many countries, notably in the world's chief lending country, Great Britain, has limited foreign loans through considerations of the need for capital and low interest rates at home and fears as to currency reserves.

I believe that foreign investment will remain at a relatively low level for some time to come, and that this will be a seriously adverse factor for the expansion of world trade. I believe moreover that when it does increase it will be under substantially different conditions from those of the past. There will be more lending in the form of the supply of goods on credit. Such public issues as are made will need to be safeguarded by new measures in the interests of the investor. They will in many cases be subject to governmental consent, and this consent will probably be dependent upon the use of the loan to buy commodities from the lending country. In a world of controlled and restricted trade, we shall no longer have a free investment of capital, but a system under which lending policy is a counterpart of trade policy. It will, like the latter, be bilateral and reciprocal and controlled in relation to national economic policy as a whole.

I will add just a word as to a different class of problems. Practically every country which controls non-self-governing colonies—even Great Britain to a small extent, in spite of her historic traditions—is to some extent using its power to secure preferential entry into their markets. This is among the factors which are adding to the dangers of war, and I

shall make some proposals with regard to it in my next and last lecture I merely note it now as one of the elements in our general problem

After this consideration of the major factors of a more or less permanent character, which are likely to determine the conditions under which international trade will take place for many years ahead of us, let us turn to the principal impediments to that trade now imposed by governments as a part of their commercial or currency policy I will summarize these briefly and as far as possible with the avoidance of unnecessary technicalities

First there are tariffs These have been increased in some cases since the financial crisis, notably in Great Britain, which had previously been on a free-trade basis In this instance tariffs were first imposed mainly for the purpose of protecting the currency, but they have been retained and extended for the protection of home industries They have moreover been combined with imperial preference with the British Dominions, and some—though at present slight—preference with the non self governing colonies In general, however, in the world as a whole there has not in recent years been a very marked change in tariff rates They remain, and their effective height has in many cases been increased by the fall of prices They have, however, come to occupy a secondary place among the impediments to trade because of the vast extension of new obstacles which we shall consider in a moment Incidentally this has had the result of making the most favored nation clause almost inoperative, since it has usually been held to apply only to tariffs The policy of Mr Cordell Hull in negotiating reciprocal tariff reductions, extended by the operation of the most favored nation clause, is a notable exception in world policy at this moment

Next we have "quotas." These have grave disadvantages over tariffs. Trade can adjust itself even to high tariffs, if they are reasonably stable, and can therefore expand in spite of them. Fixed quotas allow no such adaptation. Moreover they involve, if not corruption, at least an entirely unjustifiable gift to an intermediary, or to a special class of traders, of an amount corresponding to the revenue derived under a tariff system from customs receipts. In addition they involve much greater dislocation, since it is more difficult for an exporter to calculate whether he will get within the quota than whether he can get over a tariff. They are primarily the product of emergency; they represent the desperate efforts of a country, at a time when the whole international system has lost its balance, to protect itself from immoderate dumping, or to make discriminating reciprocal trade agreements without infringing the most-favored-nation clause in commercial treaties, or to protect its exchange by reducing imports more quickly than would be practicable by a tariff. Quotas of this kind should be temporary, and should disappear with any progress in securing stability in currencies.

There is, however, another kind of quota which may form a permanent and even perhaps a useful feature of the commercial system of the future. When a government is deliberately controlling a given sphere of production, it may sometimes need to regulate the quantities of imports, and for this purpose a quota is more suitable than a tariff. In such a case, however, the quota should be allotted to a public Imports Board and not distributed through private licenses. And in that case it is extremely desirable that by negotiation between the importing and exporting country the latter should set up a public Exports Board so that the commodities are regulated at the source and not shut out

at the last stage In this way great dislocation can be avoided and the public revenues of the two countries can benefit as they ought to by the sums which under the present system fall into the hands of intermediaries in the form of excessive profits due not to ordinary operations of trade but to the governmentally imposed restrictions Quotas will thus be the natural complement of governmental control over any particular sphere of economic production and distribution and in this form they are likely to develop just so far as planned and controlled national systems increase

I come next to exchange restrictions the most serious of all the present impediments to trade with those countries which have imposed them With some exceptions the United States Great Britain and the British Empire France and the small group of gold countries (Belgium Holland and Switzerland) do not impose such restrictions But practically all the rest of Europe including notably Germany and Italy allow foreign exchange to be obtained only under license regulate its uses and compel the handing over of foreign exchange obtained by the sale of exports The dominating motive in each case has been to maintain the nominal gold value of a currency like the mark or the lira whose purchasing value has really fallen below that nominal value or to protect a currency which no longer has a fixed gold parity from excessive fluctuation or depreciation The effect of these restrictions which have assumed a multiplicity of technical forms too complicated for me to attempt now to describe has been to limit imports to what the *restricting authority considers necessities* to reduce exports everywhere and to threaten the stoppage of even the most valuable and indispensable forms of international exchange Under these conditions trade has in some instances been reduced to its most primitive form of actual barter

quantities of goods being exchanged without the use of currency at all, in spite of the immense inconveniences involved. A somewhat less primitive method consists in "compensation agreements," under which the exchange required for the purchase of specified goods up to defined amounts is allowed by each of two countries to its importers. A more advanced and more convenient system has however developed, that of "exchange clearing." This system takes many different forms. In the simplest it consists of a joint agreement between two countries to eliminate transfers of foreign exchange so far as commodity transactions between the two countries cancel one another, and to reserve any surplus arising from excess exports by one for the purpose of settling financial obligations, such as the interest due on previous loans, with the other. The exporter of goods is paid by, and the importer pays to, his national clearing institution in his national currency, and the institution deals with any surpluses in the way prescribed in the particular agreement. As between a creditor and debtor country such a system has many advantages. For the creditor country it offers a prospect of payment of its debt while the debtor benefits from the inducement given to the creditor country to prefer its goods. And the system once started has an inevitable tendency to spread, since countries outside the system find themselves at a disadvantage in selling to those who have contracted bilateral agreements between themselves. At the same time, since there is no similar inducement to the latter countries to *sell* only to each other, countries outside the system tend to find their balances of trade becoming more adverse. The consequence has been a double one, a great extension of the system between all countries with weak currencies, and considerable resentment of the institution of the system by the others who

remain unwilling to come in Some 150 clearings are now in operation between twenty three countries, and a very substantial proportion of the trade of the world is now carried on through this system

These clearings have recently formed the subject of an elaborate enquiry, and on the whole have been adversely criticized, by a committee of the League of Nations There can, however, be little doubt that they have in many cases served a very useful, if only a temporary, purpose during the currency crisis They have enabled a great deal of trade to take place that under the conditions of the period, would otherwise have been impossible The question whether they are destined to remain, with some development and modification of form, a permanent part of the financial structure of the future, is more difficult Undoubtedly a host of bilateral agreements involve great complications, they tend to the destruction of triangular—or multangular—trade and involve much inconvenience to foreign merchants On the other hand the system can be made, and is being made, simpler and more efficient in operation, and bilateral systems can be and to some extent are being expanded into multilateral systems, under which the transactions not of two but of a number of countries are "cleared" or canceled against each other In its final development the system might allow for multilateral trade, while retaining the advantage over the free exchange system of eliminating the dislocation of exchange rates by speculative movements of liquid capital The price for this advantage is the complication of the formalities involved and the continuing tendency of the system, in whatever manner developed, to handicap triangular as distinct from bilateral trade

The future of the system will in my opinion depend

mainly upon whether the world is able to eliminate from its general currency system the particular evils which I have discussed in my earlier lectures. I shall add a little to this comment in my next lecture.

We must take the above factors in the actual situation as the elements from which either to forecast or to construct the system of the future. We have therefore now to consider finally what is the best practicable line of policy to pursue if we wish to secure an enlargement of world trade.

ent, the limiting points within which the ratios would be chosen would be 4.86 in the one direction and 5 in the other. The ratio with the franc is more difficult and at the same time more important. Undoubtedly the franc is at present overvalued. While this remains the case France is suffering deflation, which is both injurious to herself and makes her a poor customer for other countries. On the other hand if she devalues without any international agreement, there is a double danger. She may devalue too much and so inflict deflation on the rest of us; or there may be no confidence that the devaluation decided upon will be final, and there may be speculation against the franc with all sorts of consequential inconveniences both outside and inside the country. Probably 100 francs to the pound would fairly represent the franc's purchasing value, and a ratio of say 5 dollars to the pound, and 20 francs to the dollar would have a certain arithmetical convenience.

The kind of agreement that I should like to see between the three countries would be one under which they would undertake to direct their policies towards maintaining the above ratios, with a reasonable margin of variation which could be used to make speculative operations very dangerous and unattractive to the speculator. Each country would contribute to a joint equalization fund or alternatively undertake to use national funds in consultation to support this policy. In this way the ratios would be maintained unless and until a long-continued drain upon these funds in one direction, through the weakness of one or other currency, showed that either the ratios had been wrongly chosen or that they had become wrong through a changed economic situation, so that the only alternatives for the country with the weak currency would be to lower the ratio or to impose deflation on its internal currency. In that

case—the reality of the need for a change having been dem onstrated by a serious drain on the equalization funds—the alternative of a corrective change of ratio would be pre ferred to deflation Such a system would I believe, remove the fears and suspicions of competitive currency deprecia tion, afford a sufficiently stable medium of exchange for international transactions, create sufficient confidence to result in many of the present exchange restrictions being removed—and at the same time be possible of acceptance because no country would be binding itself to deflate in order to maintain an unsuitable ratio I will discuss a little later the advantage such an arrangement would have for tariff negotiations

Next, if there is to be any return to the gold standard—and any currency agreement would win more confidence if it were expressed in terms of gold—I suggest that it is essential that the central banks should cooperate to main tain a reasonable stability in the general level of gold prices I will not now discuss the technical methods by which they would achieve this object—I have discussed them elsewhere —but there can be little doubt that, except in very unfavor able conditions, such as a general financial crisis or grave political danger, the principal central banks supported by their governments could prevent the great variations in gold prices that have occurred in recent years

If measures of this kind were taken between the three principal financial centers it would be easy for the rest of the world to be associated with the scheme the gold coun tries following with France, the sterling area countries with Great Britain, and so on There would be a relief of tension everywhere, fears as to the fate of national currencies would diminish, exchange restrictions would be reduced and sim plified Clearing agreements would I think remain, at least

countries to use their collective influence to discourage foreign issues which do not satisfy certain conditions that are necessary in the interests of the investor The experience of the years 1924 28 shows very clearly what these conditions should be I have discussed them in *Recovery* and will not repeat a discussion which would here take too long It is however clear that the investor will need to be carefully nursed back to a confidence in foreign lending and the *discouragement of inadequately protected loans* by both governmental and collective private action will on the whole increase rather than diminish the extent of foreign lending by adding to the confidence of the lender Whatever is done however I believe that foreign lending will be for a long period to come on a lower level than in the pre-depression period and that the capital that goes abroad will be to a greater extent in the form of the supply of goods on short or long term credit and less in the form of public issues

Investment policy leads to a consideration of the problems of the Trade Balance and the Balance of Payments Here as I have already suggested I think the right course of action is not that governments should return to the nineteenth-century practice of letting the balances look after themselves under the laissez faire system and the operation of the gold standard I think they should each seriously and carefully examine their positions and then aim not at a *positive* balance but at equilibrium They should plan in broad outline the main items on both sides of the account—about what totals of imports and exports they aim at what classes of goods in each category are most desirable about what import or export of capital they think desirable and so on and should then use the general conception of policy so arrived at as a guide in determining

action in each particular sphere. This would involve, for example, not only a limitation of imports considered undesirable, but a positive and definite encouragement and welcome of classes considered desirable; not only a limitation of foreign lending beyond the desirable limit, but a positive encouragement of it up to that limit, and so on. The chief cause of the present impediments to trade is that the action of almost every country seems to be directed towards securing rights to more payments from abroad than it makes; and the chief reason is that arguments about the Trade Balance are used to support particular measures without the Balance as a whole being adequately considered.

I now come to the most difficult problem of tariff agreements. I believe that the general course of policy we pursued in the ten years before the crisis is not the right one for the period now ahead of us. I do not think that we shall succeed in a policy of multilateral negotiations designed to secure uniform reductions of tariffs, or the reduction of tariffs to a uniform level, or some compromise between the two. Nor do I believe that we can proceed far—though Mr. Cordell Hull has shown that something can be done in this direction—by bilateral negotiations for reductions, which are then extended to other countries by the operation of the most-favored-nation clause. Still less do I believe that success will attend the British nineteenth-century policy of one or more countries giving a lead towards free trade, or low tariffs, by unilateral action, in the hope that other countries will follow.

I believe we must now, in the main, reverse the process: not attempt to start from a conception of general free trade, or stable low tariffs, and try to impress this policy upon individual countries, but on the other hand start with the national policies and try to develop them gradually through

bilateral arrangements, towards a more liberal and extensive system. Let me be more specific.

I would advocate that each country should consider its Trade Balance and its national economy as a whole, that it should form a general conception of national policy from the point of its own interests, and that it should then have a national enquiry *to consider, whether on this basis* changes in its tariffs are desirable. I believe that an international organization, like the League of Nations, could give a valuable lead in this direction, by advocating not, in the first instance, international policy, but the examination by each country of its own position and policy *as a whole*. It could help by supplying useful information as *to what certain countries have already done in this respect*, and by furnishing much of the statistical and other material required. Action on these lines would have the great advantage of "cutting with the grain and not against the grain," of helping countries to do what they are inclined to do and not trying to persuade them against their will. And reasonable national policies would represent an immense *advance upon the present position*. During years of negotiations at Geneva I came to the conclusion that the greatest obstacle to international agreement was not a conflict of national interests, but the fact that governments were not masters in their own home, not a conflict of national policies but the fact that there were no national policies conceived as a whole—that there was merely a complex of *measures improvised under the pressure of sectional* groups or successive emergencies. When one penetrated behind the formal statements to the real minds of the national delegates, one found they were usually preoccupied not with the general interest of a national policy, whether wisely or unwisely conceived, but a calculation of politi

cal pressures of groups in their respective Parliaments.

Let me illustrate the advantages of the course I am now advocating. When Mr. Stanley Bruce, President of the League Council during the Ethiopian crisis, was Prime Minister of Australia, he arranged for an examination of the Australian tariff system by a number of Australian economists, who were required to take as given the general protectionist system of the country and to consider the actual tariffs in relation to it. They recommended unanimously the removal or reduction of many duties which were clearly injurious to Australia as well as handicapping seriously the exports of other countries. There are indeed a very great number of existing tariffs which are demonstrably bad on any view of national policy. Let me give you an example of what I mean. I know a business in England which used to export racing rowing boats to India. A 40% tariff was applied to a whole category of imports which included these boats incidentally and accidentally. What was the effect? It did not protect an Indian industry, for there is no industry in India which makes such boats or contemplates doing so. It did not bring in any revenue, for the higher price resulting from the duty made the boats too expensive for the rowing clubs, and they stopped buying altogether so that no customs duties were paid. It did not protect the Indian currency, which did not need or desire any relief from the Trade Balance. Now those are the only three reasons for which tariffs are ever intentionally imposed, and none of them applied, but still the tariff remained—with the sole result of preventing those in India who wished to row from being able to do so. This is perhaps an extreme example, but it is representative of a great number of injurious impediments to trade which no candid enquiry, however national in outlook, would justify.

The elimination of these obvious anomalies is of course only a first step A candid and comprehensive national enquiry would go much further Having considered the Trade Balance as a whole it would conclude that if exports were desired *an appropriate volume of imports* (after due allowance for borrowing or lending operations) would be necessary It would consider what classes of imports it was most desirable for the country to buy and would then advocate a tariff system which would positively encourage these imports And it would soon arrive at a principle the application of which would be of the utmost value to world trade It would consider as regards each *particular category of goods not whether the country could* produce it but whether (having regard to the Trade Balance as a whole) it could produce it well enough and cheaply enough It would soon come to the conclusion that where a specially high tariff was necessary to secure the home production of a given article it was better that that article should be imported It would then be in a position to advocate not the increase of the relevant tariff but its reduction or even *its removal And this would give a basis* for bargaining with other countries on the principle of complementary exchange each country producing that for which its natural resources or aptitudes best qualify it—the true foundation of all international trade

This of course is precisely the opposite of the miscalled scientific principle of making a tariff just high enough to compensate for differences in costs of production the absurdity of which I have already discussed *in an earlier lecture*

Already therefore a purely national enquiry starting with a purely national outlook but comprehensive in its scope intelligent and well informed would be likely to

lead to considerable reductions of the present impediments to trade. But it would not stop here. It would soon lead to, and provide the basis for, reciprocal agreements with other countries.

Now I believe that in the present world these negotiations will have the best chance of success if they are in the first instance bilateral, or plurilateral as distinct from universal, and conducted under conditions which enable the negotiating countries to give advantages to each other which they will not necessarily extend to the rest of the world. I believe that the first enlargement of trade will come from such negotiations between pairs, or groups, of countries, which have stronger inducements to expand trade with each other than with the rest of the world: countries with close economic relations, like Belgium and Holland; countries whose production is naturally complementary, like England and Australia; countries whose currency systems are sufficiently related to remove currency fears as an obstacle to commercial treaties, like countries now within the sterling area; countries whose tariff systems are relatively low, like Sweden and Holland.

Now this proposal brings me right to the heart of the problem of the most-favored-nation clause. I have already referred to this clause and the way in which it stopped the trend towards bilateral treaties that followed the World Economic Conference of 1927. Let us look into the question a little more closely.

The traditional policy of Great Britain as a free-trade country in the nineteenth century was to claim from countries with tariffs the right of entry for British goods at whatever might be the lowest rate of duty granted, for any given category of commodities, to any other country. This was willingly granted since Great Britain admitted all goods

free Often a similar clause was inserted in commercial treaties between pairs of countries with comparable tariff systems Later the clause has also been inserted between countries with very different systems—high tariff and low tariff countries, for example With this last extension the effect is necessarily to prevent agreements for tariff reduction between two low tariff countries, for they are likely to be unwilling to extend to other countries reductions which they would be quite prepared to make to each other

As the most favored nation clause prohibits them from making preferential agreements of this kind, they either give up the attempt to increase their mutual trade, or they dodge the clause by quotas or other devices On the whole the clause is now in part an obstacle to desirable tariff reductions, in part it has become in practice inoperative

At the same time the clause has served some very useful purposes It has prevented many of the dangerous complications and confusions of political and economic motives which arise when a country is free to distribute its favors unequally For a long time it saved the world from a chaos of complicated differentiating tariff systems It would be regrettable if the principle disappeared altogether

We shall not, however—as recent experience has demonstrated conclusively—avert the danger of this principle being inoperative by making the most favored nation clause sacrosanct in its extreme and unconditional form The result of that policy must be that it will be dodged and ultimately denounced and that in the meantime it will impede tariff reductions along the only practicable path of progress —that of agreements between pairs or groups of countries with complementary production and comparable tariff and currency systems

The solution, in my view, is neither to abolish the clause,

nor to preserve it in its present form, but to extend considerably the conditions under which exceptions (for which there are already some precedents) are customarily allowed.

I think, to be specific, that countries which have the right to most-favored-nation treatment under commercial treaties should agree not to insist on it in the case of preferential agreements under carefully defined conditions.

These conditions should, in my view, be roughly those which were satisfied by the Commercial Treaty which Belgium and Holland negotiated with each other at Ouchy in 1932—namely that there should be reciprocal, substantial, and progressive reductions as between the contracting parties, without any increase of tariffs against other countries, and that the arrangement should be open to other countries on the same or similar conditions.*

I consider that the action of Great Britain in blocking the Ouchy treaty, though legally justified, was extremely regrettable, especially at a time when imperial preference was being negotiated on a basis which was far from complying with such conditions as those indicated above.

Under such an arrangement as I now suggest, I believe that there would be a powerful inducement to pairs and groups of countries to form "low tariff clubs," and to others to be willing to come in, and to be welcomed in, as the movement proceeded. World trade would be built up again from national policies, through bilateral and then multilateral negotiations and treaties. Gradually—but perhaps not slowly—a stable system would be built up for an enlarged and expanding world trade.

This in a word is the probable structure of world trade

* I would commend especially as a model the resolutions officially adopted by the U.S.A. and practically all the States of South America at the Montevideo Conference of 1933.

of the future—and in my view the practicable policy we *should pursue if we wish to assist it*

I have a few notes to add before I conclude I have referred several times to the impossibility of negotiating tariff treaties between countries whose currencies bear no reasonably stable relation to each other Now let me point out *how my currency stabilization proposal would remove this* difficulty If a provisional stabilization agreement of the kind I suggested were made tariff negotiations could proceed on the assumption that it would be successful in maintaining stable exchanges At the same time a proviso could be inserted in any *commercial treaty that might be con*cluded to the effect that if the currency ratio were changed any signatory to the commercial treaty could denounce it if it considered that it had thus been deprived of the advantages of the treaty Thus the safeguarding provisos in the stabilization agreement and the commercial treaties would be complementary There would be a double advantage in this relation A country benefiting from the commercial treaty would have an additional inducement to maintain its currency ratio for fear that it might otherwise lose the advantage of tariff concessions On the other hand if a change in the currency ratio were inevitable the system proposed would be likely to ensure that it would be genuinely corrective and not a method of competitive depreciation and would be recognized as such In that case a country legally entitled to denounce the commercial treaty would be unlikely to exercise that right especially if it had itself experienced the benefits of the tariff concessions it had secured

I must add before *I conclude a proposal with regard to* colonial policy I think that British and Dutch colonial policy in the pre-depression period was based on principles

which were to the benefit alike of all the three interests concerned, the metropolitan countries, the colonies, and the rest of the world. In effect their colonial government was based on a conception of double trusteeship, first the interests of the inhabitants and then the trade of other countries. And the practical application of this conception as regards commercial policy was a régime of equal entry for the goods of all countries, with no preference for the country governing the colony. I profoundly regret that my country has departed from this principle in the last few years. It is true that other countries have in general no justification for complaint, since they have almost always either incorporated any colonies they govern themselves in their own protectionist régime or established substantial preferences in favor of their own nationals. It is also true that so far the exceptions made have been slight and without much practical effect. Nevertheless a precedent has been established which might lead to a considerable further development. The grievance of countries without colonies has been increased, and the economic effects have assumed in their minds a fantastically exaggerated form, which has made them a real factor in the world's political situation. Throughout the chief era of great expansion the principle of the open door, or equality of economic opportunity, to all British colonies for all comers was not only a justification but an element of safety for the whole of the vulnerable and dispersed British Empire. It would, I think, be wise for Great Britain to return to the earlier policy of complete equality of economic opportunity for all countries in the trade of non-self-governing colonies, and to offer to bring these colonies under the Mandate System and render an account for the discharge of British imperial responsibilities. I use the phrase "equality of economic op-

portunity" rather than the "open door," because if the world enlarges its trade, as I conceive it will, through expanding low tariff groups with preferential advantages *inter se* I see no reason why colonies should be deprived of the benefit of this process The essential thing is that there should be no advantage to the metropolitan country as such as compared with other countries Great Britain has already offered to join an enquiry as to the distribution of colonial raw materials I should like this to be extended to the question of import duties Obstacles, not to the purchase of raw materials, but to entry into colonial markets are the real grievance of non-colonial powers I think this is a real grievance, though its practical value has been exaggerated, and I should like Great Britain to take the lead in removing it But I need hardly add that she is unlikely to act alone

What I have just said refers to non self governing colonies It has no application to the British Dominions These are self governing countries in the fullest sense, completely masters of their own commercial policy The relations between them, and with Great Britain, should, I consider, be subject to exactly the same principles as those which apply to commercial relations with other countries I would apply this to the fullest extent I see no reason whatever why the fact that these self-governing governments recognize the same King should justify them in establishing preferences *inter se* if they prevent the establishment of preferences between other countries by virtue of the most favored nation clause, and this is one of the reasons, though only one, why I have advocated the modification of that clause

Well, that is my policy in outline The various proposals which I have made are inter related and interdependent Taken as a whole they represent in my view the course of

action which, among the practicable alternatives, is most likely under the conditions of the modern world to secure a large and a beneficial enlargement of world trade which will assist the prospects of both prosperity and peace. It is a policy adjusted to the distinctive economic development of our age, the close association of national governments with national economic enterprise. The international negotiations which I contemplate as influencing the direction of private enterprise in external trade are a counterpart of national direction within each country. The policy contemplates a governmental responsibility in regard to foreign investment which is the counterpart of its regulation of imports. It contemplates a currency reform which shall secure that currency shall be, as all the mechanism of finance and investment ought to be, the servant of trade and industry. It aims at securing a system under which the form and structure of external trade will take its proper place in the structure of trade and economic enterprise as a whole. And above all it tries to attain its goal by working upwards and outwards from what we have. It aims at first rendering national policies more intelligent and consistent, then liberalizing and expanding them into a system under which pairs and groups of countries of comparable or complementary ambitions will extend the range of their reciprocal trade, and so gradually widening and merging these areas of extending trade till at last a new and more stable world system is established. No frontal attack upon economic nationalism by the methods appropriate to an earlier age of laissez faire will in my view succeed. Let us by all means retain the ideal of a world system, under which men of all countries will freely exchange the products of their skill and industry. But let us realize that such a system requires a balanced and related progress in every sphere—in collective government,

in the collective regulation of investment, in the collective control of currency as well as in commercial policy It is an idle dream to think we can secure an abolition of all tariffs in a world organized as our own in national units in each of which a national government is directing and participating in national economic enterprise In such a world we must aim at an evolution from within We must I suggest regard our present economic nationalism not simply as an enemy we have to slay but as the possible parent—with proper encouragement and education—of a better system than itself